Supreme Court, U.S.
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No. OFFICE OF THE CLERK

In the Supreme Court of the United States

CERTAIN UNDERWRITERS AT LLOYD'S, LONDON,

Petitioner,

v.

ZEV LAGSTEIN,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This petition arises out of an arbitration over a rejected claim for "total-disability" insurance. Even though respondent had returned to work soon after his surgery and was earning millions of dollars a year in his cardiology-consulting practice, a two-arbitrator majority awarded "disability" benefits for the full five-year term of the policy, added $1.5 million for "emotional distress," and set a second hearing – beyond the deadline agreed to by the parties for issuing any award – resulting in a further award of $4 million in punitive damages. During the proceedings, petitioner discovered that (a) one of the arbitrators in the majority had resigned from the state-court bench to avoid federal prosecution for judicial misconduct and was subject to a lifetime ban from state judicial service, and (b) the other, when a member of the state supreme court, had unlawfully sought to frustrate the State's investigation into his co-arbitrator's judicial misconduct. The arbitrators had failed to disclose this information to the parties. The questions presented are:

1. (a) Whether review of an arbitration award for "manifest disregard of the law" or "complete irrationality" remains available after *Hall Street Associates, L.L.C.* v. *Mattel, Inc.*, 552 U.S. 576 (2008), a question that this Court again expressly reserved in *Stolt-Nielsen S.A.* v. *AnimalFeeds International Corp.*, 559 U.S. __, 130 S. Ct. 1758 (2010), and on which there is a clear Circuit conflict; and

(b) If such review is available, may a reviewing court determine whether an award is irrational under the totality of the circumstances (as the district court did here and as the Second Circuit permits), or are awards impregnable unless it is "clear

from the record that the arbitrators recognized the applicable law and then ignored it" (as the Ninth Circuit below held).

2. Whether the Federal Arbitration Act ("FAA") requires vacatur of an arbitral award issued by arbitrators who failed to disclose material facts bearing on their integrity and their relationships with each other, in violation of the applicable rules governing arbitrations, or (as the Ninth Circuit held) are arbitrators required to disclose only their relationships with the parties and counsel, with the burden to investigate and unearth other material facts falling on the parties.

3. Whether arbitrators "exceed their powers" within the meaning of Section 10(a)(4) of the FAA when they issue an arbitral award after the deadline expressly agreed to by the parties in accordance with the governing arbitration rules.

RULE 29.6 STATEMENT

Petitioner Kiln, which appeared below on behalf of those Certain Underwriters at Lloyd's, London subscribing to Certificate No. 997401, is a wholly owned subsidiary of Tokio Marine & Nichido Fire Insurance Co., which is held by Tokio Marine Holdings, Inc., a company traded on the Japanese stock market.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Certain Underwriters at Lloyd's, London ("Underwriters"), petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The order of the district court vacating the underlying arbitration awards (App. 22a-27a) is unreported. The opinion of the Ninth Circuit reversing the district court (App. 1a-21a) is reported at 607 F.3d 634.

JURISDICTION

The judgment of the court of appeals was entered on June 10, 2010. App. 1a. The order of the court of appeals denying Underwriters' timely petition for rehearing was entered on July 27, 2010. App. 35a. This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The Federal Arbitration Act provides in pertinent part:

"*Section 5.* If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; ...." 9 U.S.C. § 5.

"*Section 10.* (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration –

"(1) where the award was procured by corruption, fraud, or undue means;

"(2) where there was evident partiality or corruption in the arbitrators, or either of them;

"(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

"(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)

INTRODUCTION

This Court has recognized that arbitration offers advantages to parties in commercial disputes. It is prompt and cost effective. The parties may determine the procedures to be followed, including the time within which the dispute must be resolved. Most important, they can select the persons in whom they repose confidence to resolve their dispute objectively, independently, and rationally in light of the law and the facts.

In this case, however, the Ninth Circuit held that parties are not entitled to these assurances.

STATEMENT

A. Lagstein's Disability-Insurance Policy

Respondent Zev Lagstein is a successful cardiologist and disability examiner. He conducts an office-based practice administering and interpreting non-invasive diagnostic tests. DER502-03, 527-29. (Defendant's Excerpts of Record). In 1999, he purchased an insurance policy from Underwriters covering "total disability." If he became unable to "perform

in ***any professional capacity*** within the medical profession" for at least 90 days (the "elimination period"), he would accrue a $15,000 monthly benefit (up to five years) so long as he remained unable to perform in any professional capacity. DER276-85 (emphasis added).

B. Lagstein's Surgery

In August 2001, Lagstein learned that he had "Moderate Aortic Stenosis." His cardiologist advised him to undergo "elective" heart-valve replacement surgery, a significant but common procedure. DER213-15. Lagstein scheduled this surgery for November 21, 2001, but stopped working on October 23. DER505. After surgery, his surgeon predicted full recovery within eight weeks. DER511-12, 553-54.

C. Lagstein's Claim and Clandestine Return to Work

Lagstein filed a claim under his total-disability policy on December 4, 2001. DER539-41. On December 10, Underwriters informed him of additional information needed to process his claim, much of which he failed to submit, and updated him monthly on outstanding issues. See, *e.g.*, DER209, 216, 440, 542-49.

The earliest that Lagstein could have received a payment under his policy was February 21, 2002 (30 days after the 90-day elimination period, even using October 23 as the disability date). DER272, 285, 532-34. On January 22, 2002 – eight weeks after his surgery, 91 days after he stopped working, and 29 days before the earliest date that benefits could be paid – Lagstein certified to his hospital that he was fit and ready to work. DER218-23. Consistent with that certification and his surgeon's post-operative

prognosis, Lagstein returned to work on February 8, 2002. DER225-28, 532-33.

By the end of that year, Lagstein was again making millions of dollars at his practice (DER74), performing tasks that he admitted were "easy," "not difficult," and "like reading the paper for me" (DER528-29). When pressed about his ability to practice, Lagstein insisted that his practice is "an easy way of working," is "no big thing," and asked, rhetorically, "why shouldn't I do it?" DER523-28.

Lagstein concealed his return to work. Underwriters discovered Lagstein's deception, fortuitously, in April 2002, when a claim-handler noticed that one of Lagstein's recent medical records described him as wearing a doctor's coat. DER559-63. What followed was a protracted investigation into Lagstein's surreptitious return to work. See, *e.g.*, DER510, 568-71 (Lagstein refused to allow an investigator to review his office calendar and later claimed that it was destroyed in a fire). After Underwriters received materials from Lagstein's lawsuit against another insurer, it denied his claim because he had failed to meet the 90-day elimination period. Underwriters concluded that Lagstein was unable to "perform in any professional capacity within the medical profession" only from November 21, 2001, until February 8, 2002 – for only 80 days. DER590-93.

D. Selection of Arbitrators

After Lagstein sued, the district court ordered arbitration under the policy's arbitration clause, which made the arbitration subject to the American Arbitration Association ("AAA") Commercial Arbitration Rules (DER286). Those rules require that arbitrators be impartial and independent. AAA

Rules R-12(b), R-17. The arbitrators here explicitly acknowledged their obligation to act as independent neutrals. DER287.

Lagstein proposed former Nevada state judge Jerry Carr Whitehead as sole arbitrator. Whitehead was unknown to Underwriters' counsel, and Underwriters declined to accept him as sole arbitrator. DER185-92. Underwriters proposed Ralph Williams as a second arbitrator. Whitehead provided Williams with a short list of potential third arbitrators, and the two agreed on former Nevada Supreme Court Justice Charles Springer, who served as chairman. DER289-90.

As required by AAA Rules, the arbitrators provided disclosure statements. DER289-90. Whitehead disclosed several prior mediations for Lagstein's counsel and indicated that he had "mediated multiple cases" for other insurance syndicates using Lloyd's administrative infrastructure.[1] DER289-90. However, he had never mediated – or arbitrated – a dispute in which Underwriters had been involved. DER491-93. Springer's disclosure indicated merely that he had no prior relationships with the parties or attorneys. PER85-86 (Plaintiff/Appellant's Excerpts of Record).

Counsel for Underwriters (attorneys based in California) performed routine background research looking for published opinions that Springer or Whitehead had authored on legal issues pertinent to Lagstein's claim. They did not look for, suspect, or

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[1] For a general description of the Lloyd's of London insurance market, see *Society of Lloyd's* v. *Jaffray*, [2000] EWHC 51, §§ 10, 21, 2000 WL 1629463 (Q.B. Nov. 3, 2000), aff'd [2002] EWCA Civ 1101 (Court of Appeal).

discover anything extraordinary about Springer or Whitehead or their prior relationship. DER185-92. Relying on the disclosures they were given – along with the fact that both Whitehead and Springer held themselves out as retired judges (DER289-90, PER85-86) – Underwriters raised no objection to them.

E. Arbitration

At the close of the hearing in July 2006, the arbitrators acknowledged that "[u]nder AAA rules" – which are binding here (see DER286) – "a decision is required generally within 30 days," but they requested a "15-day extension" of their authority. DER598-99. The parties stipulated that the award could be issued as late as "September 1st, 2006." *Ibid.*

On September 1, the arbitrators issued a split decision. Whitehead and Springer found that Lagstein was permanently unable to perform *in any capacity within the medical profession* – even though he continued to work at a multi-million-dollar medical practice that he described as "easy." App. 43a-62a. They also found that Underwriters had "repudiated" the policy by violating "highly critical language of the Policy" (*id.* at 50a, 96a-97a), even though that language appeared in an *optional* coverage that Lagstein had ***not*** purchased, and that was thus ***not*** part of his contract.[2] Whitehead and Springer then awarded Lagstein the maximum five years of "accelerated" benefits under the policy

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[2] The language was contained in the definitions for "Section 2" coverage. DER282. Lagstein had not purchased this option. DER272.

($900,000), plus $1,500,000 for "mental distress," and his attorneys' fees. App. 101a-108a.

The majority also found Underwriters liable for punitive damages and ordered a second hearing, after the September 1 deadline, to determine the amount. *Id.* at 108a.

Williams dissented, concluding that the majority had rewritten the policy, exceeded its authority, and acted in manifest disregard of the law and facts. App. 110a-128a. He found, however, that Underwriters should have used October 23 as the date of Lagstein's disability and thus owed Lagstein (only) approximately two weeks of benefits. *Ibid.*

F. Discovery of the Whitehead Affair

1. The majority's seemingly inexplicable rulings made Underwriters' counsel suspicious that something untoward was occurring. DER185-92. They discovered some remarkable facts that had not been disclosed.

Counsel learned that the Nevada Commission on Judicial Discipline had filed a complaint against Judge Whitehead alleging a pattern of willful misconduct on the bench. Nevada law affords each party a right to strike the judge initially assigned to a case; the Commission alleged that Whitehead had systematically sought to nullify that right by:

(i) initiating *ex parte* contacts with the adversaries of parties who had exercised the strike right, allowing the adversary to select the replacement judge;

(ii) contacting partners of lawyers who exercised the strike right, threatening to retaliate against their firms; and

(iii) directly contacting parties whose counsel had exercised the strike right to complain about their counsel, resulting in several replacing their counsel, in one instance with Whitehead's son's law firm. DER310-21.

Whitehead had sued to stop the investigation. During appeals in that lawsuit, Springer, as a member of the Nevada Supreme Court, invariably ruled in favor of Whitehead. (Springer earlier had solicited Whitehead to run for the state supreme court. See DER449.) Springer and another justice undertook a series of increasingly aggressive efforts to stack the panel of the court hearing the appeal, quash the complaint against Whitehead, and punish the Discipline Commission that had issued the complaint, as well as the Nevada Attorney General who supported it, dissenting justices of the Nevada Supreme Court, and others. See, *e.g.*, *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 878 P.2d 913, 923-934 (Nev. 1994) (Springer, J, concurring); *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 920 P.2d 491 (Nev. 1996).

Later panels of the Nevada Supreme Court declared Springer's defense of Whitehead to be *ultra vires*. For example, Springer and another judge used their "personal funds" to hire a "special master" to investigate alleged violations of their "secret orders" trying to protect Whitehead. The court later condemned this "extra-constitutional" "witch hunt" on Whitehead's behalf, striking Springer's orders as *ultra vires*. See *Del Papa, Attorney General* v. *Steffen, Springer et al.*, 920 P.2d 489, 489-91 (Nev. 1996) (per curiam); see also *Del Papa, Attorney General* v. *Steffen, Springer et al.*, 915 P.2d 245, 253 (Nev. 1996).

While this was presumably a matter of local notoriety in the Nevada legal community at the time, it was unknown to Underwriters (an English insurer) or to its California-based counsel. Ultimately, the FBI launched its own investigation of Whitehead, and the Justice Department began a grand jury probe. DER120-21. Although Whitehead held himself out as a "retired judge" (DER289-90), Underwriters' counsel discovered that federal prosecutors had *forced* him to leave the bench and accept a *lifetime ban* on judicial service *to avoid prosecution for this judicial corruption* (DER385-86). For years – including the period when Underwriters was considering Whitehead as a potential arbitrator – the fact of the non-prosecution agreement and his lifetime ban from state judicial service was obscured from the public. See note 4, *infra*.

2. After uncovering this remarkable history, Underwriters sought opinions from two experts on professional ethics, Professors Geoffrey Hazard and Stephen Gillers. Both opined that (i) Whitehead was obligated to have disclosed his non-prosecution agreement and (ii) Springer was obligated to have disclosed his previous adjudication of the cases in which Whitehead was the plaintiff and what the Nevada Supreme Court had found were his "extra-constitutional" efforts to help Whitehead block the investigation into his misconduct. DER94-184.

Underwriters then asked Whitehead and Springer to recuse themselves. They refused and, over Underwriters' objection, proceeded to hold a hearing on punitive damages.

G. Separate Punitive Damages Hearing and Award

The punitive-damages hearing was held in November 2006, over Underwriters' objections that Springer and Whithead should have recused themselves and that, under AAA rules and the parties' express agreement at the end of the first hearing, the arbitrators had no power to act past September 1.

Nevertheless, Whitehead and Springer teamed up again to award Lagstein $4,000,000 in punitive damages. App. 129a-155a. That made Lagstein's total recovery for less than four months off work approximately $7,000,000.

Williams again dissented, concluding that the arbitrators had lost authority to act beyond September 1, making the second award *ultra vires*. App. 156a-167a.

H. Proceedings Below

1. Underwriters moved to vacate both Awards. The district court (Judge Robert Jones) found that the Whitehead-Springer award was irrational and in manifest disregard of the law, and that the arbitrators had behaved so egregiously that their conduct implied a bias against Underwriters or its counsel.[3] Among other findings, the court concluded that it

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[3] Whitehead and Springer stepped out of their proper role as neutral arbitrators to become advocates for their award. They submitted unsolicited statements defending their non-disclosures, employing injudicious language. See, *e.g.*, DER466 (Springer quoting Hitler's words from MEIN KAMPF to accuse Underwriters of "the grossly impudent lie" for suggesting that there was a connection between Springer and Whitehead that they should have disclosed).

"shocked the conscience" to award Lagstein $15,000 a month in "total disability" benefits for the full five-year period covered by the policy, even though Lagstein was working at his lucrative profession virtually all that time. App. 25a, 30a-32a.

The court vacated the punitive award because Whitehead and Springer had exceeded their powers by conducting the second hearing and issuing the punitive award months after the explicit deadline for arbitral action set by the parties. The court held that their punitive award "certainly goes beyond jurisdiction[al] time with respect to the punitive damages." App. 33a; see also App. 25a.

2. Lagstein appealed. The Ninth Circuit (Judges Canby, Betty Fletcher, and Graber) reversed and ordered both arbitration awards confirmed. App. 1a-21a. The Ninth Circuit concluded that the district court exceeded the scope of review under the FAA when vacating the arbitration awards as irrational and in manifest disregard of the law. The court held that any such review is limited to situations in which it is "clear from the record that the arbitrators recognized the applicable law and then ignored it." App. 9a.

The Ninth Circuit also held that the FAA requires a potential arbitrator to disclose only information concerning the arbitrator's "relationships with the parties, their attorneys, and those attorneys' law firm," *but nothing else*. App. 20a. The court ruled that the burden is on the parties to investigate po-

tential arbitrators to discover any other types of information that might be material.[4]

Finally, the panel held that the district court erred in vacating the untimely punitive award. The panel declared that arbitrators are entitled to almost complete deference when setting or revising the "procedures" for the arbitration, including the number and length of hearings and the time for issuing the award, regardless of the parties' contrary agreement. App. 12a-17a.

REASONS FOR GRANTING THE PETITION

Every year, hundreds of thousands of disputes that otherwise would clog court dockets are resolved through arbitration. The AAA alone, whose Rules governed this arbitration, "administers approximately 150,000 cases" each year. AAA, *Statement of*

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[4] The Ninth Circuit asserted (incorrectly) that Underwriters could have discovered information about Whitehead's resignation to avoid federal prosecution and about the Springer-Whitehead history. App. 20a n.11. Although there recently has been some resurgence of interest in Whitehead's downfall – because of both this case and the 2007 publication of a book taking Whitehead and Springer's side in this controversy (see Donald Dickerson, WHITEHEAD REVISITED: THE CONSPIRACY TO STACK THE NEVADA SUPREME COURT (2007)) – the situation was different in 2005, when Underwriters accepted them as arbitrators.

Until Underwriters moved to vacate, the full truth about these men was harder to uncover. See, *e.g.*, DER185-92, 423-36, 480-90. Indeed, the only "source" for the critical information that Lagstein alleged Underwriters could have discovered is the website of a small Nevada on-line journal. That website first went on-line three months ***after*** Underwriters moved to vacate the awards. See DER480-90.

Ethical Principles for the American Arbitration Association, an ADR Provider Organization, Preface, at http://www.adr.org/sp.asp?id=22036. Parties to arbitration voluntarily forfeit many of the procedural rights that they would have enjoyed if they had chosen to litigate in court. In exchange, however, they gain several important advantages. See *Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 559 U.S. __, 130 S. Ct. 1758, 1773-1775 (2010).

The decision below upsets the balance that makes arbitration a viable and often attractive alternative to litigation. It forces parties choosing arbitration not only to forfeit normal appellate review of the arbitrator's award, but also to accept an unlimited financial risk, with no recourse even for fundamental breakdowns in the adjudicative process. The decision also strips arbitration of three of its core benefits: the rights (i) to make an informed selection of the persons who will exercise nearly final authority to resolve the dispute; (ii) to agree upon efficient and effective procedures for the adjudication; and (iii) to control the costs of the process.

I. The Court Should Resolve the Acknowledged Conflict About The Circumstances Under Which An Arbitration Award May Be Vacated.

A. The Circuits Are In Disarray Over The Scope Of Review Of Arbitration Awards.

1. In *Hall Street Associates, L.L.C.* v. *Mattel, Inc.*, 552 U.S. 576 (2008), this Court held that parties may not *expand* the scope of review of arbitration awards under the FAA, explaining that "§§ 10 and 11 respectively provide the FAA's exclusive grounds for expedited vacatur and modification." *Id.* at 583.

Specifically, the Court held that Section 10 does not allow parties to authorize federal courts to review arbitration awards for "mere" factual and legal errors. *Id.* at 583-85.

The Court recognized, however, that Section 10 had been interpreted as supporting vacatur, in certain limited circumstances, based on a review of the merits of the award. *Id.* at 586. Before *Hall Street*, courts conducting this limited review of the merits had held that an arbitration award could be vacated if it

- was in "manifest disregard of the law" (see, *e.g.*, *Porzig* v. *Dresdner, Kleinwort, Benson, N. Am. LLC*, 497 F.3d 133, 139 (2d Cir. 2007));
- was "completely irrational" (see, *e.g.*, *Kyocera Corp.* v. *Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 997-998 (9th Cir. 2003) (en banc); *Hoffman* v. *Cargill Inc.*, 236 F.3d 458, 461 (8th Cir. 2001));
- failed to "draw its essence" from the underlying contract (*Broadway Cab Coop.* v. *Teamsters & Chauffeurs Local Union No. 281*, 710 F.2d 1379, 1382 (9th Cir. 1983)); or
- was "arbitrary and capricious" (*Peebles* v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 431 F.3d 1320, 1326 (11th Cir. 2005)).[5]

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[5] Review of the merits of an award also is implicit in Section 10(a)(2), which authorizes vacatur for "evident partiality or corruption in the arbitrators." See *Commonwealth Coatings Corp.* v. *Cont'l Cas. Co.*, 393 U.S. 145, 147 n.1 (1968). Partiality or corruption may become evident in the award itself. For example, here the district court found that "internally the bias [of the

The Court in *Hall Street* reserved the question whether any of these pre-existing judicial doctrines survived (i) as an independent basis of review, (ii) as a gloss on one of the enumerated provisions in Section 10, or (iii) as a type of penumbral review that "refer[s] to the § 10 grounds collectively." 552 U.S. at 585.

Last Term, in *Stolt-Nielsen*, the Court again declined to reach this issue, stating: "We do not decide whether 'manifest disregard' survives our decision in [*Hall Street*] as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10." 130 S. Ct. at 1768 n.3.

2. Meanwhile, the courts of appeals have fallen into further disarray and reached conflicting conclusions on the answer to these questions.

The First, Fifth, Eighth, and Eleventh Circuits have held that, in light of *Hall Street*, the grounds for vacatur identified in Section 10 are exclusive and that there is no room for inquiry into the merits, such as considering whether the award is "irrational," "fails to draw its essence from the agreement," or is in "manifest disregard of the law." See *Ramos-Santiago* v. *United Parcel Serv.*, 524 F.3d 120, 124 n.3 (1st Cir. 2008); *Citigroup Global Mkts.* v. *Bacon*, 562 F.3d 349, 358 (5th Cir. 2009); *Medicine Shoppe Int'l, Inc.* v. *Turner Invs., Inc.*, 614 F.3d 485, 489 (8th Cir. 2010); *Frazier* v. *CitiFinancial Corp.*, 604 F.3d 1313, 1323-1324 (11th Cir. 2010).

The Second and Ninth Circuits, in contrast, have held that their prior standards of review survive as

arbitrators] is demonstrated by the amount of the award." App. 33a, see also App. 25a.

judicial glosses on the grounds enumerated in Section 10. See *Stolt-Nielsen SA* v. *AnimalFeeds Int'l Corp.*, 548 F.3d 85, 94 (2d Cir. 2008) ("'manifest disregard of the law'"), vacated on other grounds, 130 S. Ct. 1758 (2010); *Comedy Club Inc.* v. *Improv W. Assocs.*, 553 F.3d 1277, 1290 (9th Cir. 2009) ("completely irrational" and "manifest disregard of the law"), cert. denied, 130 S. Ct. 145 (2009).

Other Circuits are treating the issue as open. See, *e.g.*, *Paul Green Sch. of Rock Music Franchising, LLC* v. *Smith*, 2010 WL 2993835, at *3-*4 (3d Cir. Aug. 2, 2010); *MCI Constructors, LLC* v. *City of Greensboro*, 610 F.3d 849, 857 n.5 (4th Cir. 2010); *Regnery Publ'g, Inc.* v. *Miniter*, 368 F. App'x 148, 149 (D.C. Cir. 2010); *Hicks* v. *Cadle Co.*, 355 F. App'x 186, 196 (10th Cir. 2009) (per curiam); *Grain* v. *Trinity Health, Mercy Health Servs., Inc.*, 551 F.3d 374, 380 (6th Cir. 2008), cert. denied, 130 S. Ct. 96 (2009).

As many commentators have recognized, there is no hope of certainty or consistency on this issue unless this Court intervenes. See, *e.g.*, Maureen Weston, *The Other Avenues of* Hall Street *and Prospects for Judicial Review of Arbitral Awards*, 14 LEWIS & CLARK L. REV. 929 (2010); Karly Kauf, *'Manifest' Destiny: The Fate of the 'Manifest Disregard of the Law' Doctrine After* Hall Street *v.* Mattel, 3 J. BUS. ENTREPRENEURSHIP & L. 309 (2010); Hiro Aragaki, *The Mess of Manifest Disregard*, 119 Yale L.J. Online 1 (2009); Timothy O'Shea, *Arbitration's Appeal: The Grounds Have Narrowed*, 66-JUL BENCH & B. MINN. 31 (2009); Robert Ellis, *Imperfect Minimalism: Unanswered Questions in* Hall Street Associates, L.L.C. *v.* Mattel, Inc., *128 S. Ct. 1396 (2008)*, 32 HARV. J.L. & PUB. POL'Y 1187 (2009); Alan Leeth, *et al.*, *Have Courts Shown a "Manifest Disre-*

gard" for Hall Street Associates, LLC *v.* Mattel, Inc.*?*, 28 No. 5 BANKING & FIN. SERVICES POL'Y REP. 13 (2009).

B. This Issue Is Profoundly Important.

The Court should grant review to resolve the conflict and settle the issue.

The vacatur standards under the FAA apply to hundreds of thousands of arbitrations conducted every year. The current state of uncertainty defeats the very purpose that the Court cited for limiting review of arbitration awards in the first place: "maintain[ing] arbitration's essential virtue of resolving disputes straightaway." *Hall Street*, 552 U.S. at 588. Until this Court resolves the question that it twice recently has deferred, parties and courts will be forced to expend resources guessing at what constitutes permissible grounds for appropriate judicial review of arbitration awards.

This Court has frequently recognized the "national policy favoring arbitration" (*Hall Street*, 552 U.S. at 588) that Congress endorsed when it enacted the FAA. A holding that Section 10 has sufficient play in the joints to permit vacatur when the reviewing court is convinced, under the totality of circumstances, that there has been a fundamental breakdown in the adjudicative process will promote the use of arbitration and will further that policy. Indeed, although couched in pro-arbitration language, the Ninth Circuit's decision is decidedly hostile to arbitration. The message it sends is that defendants can be exposed to limitless liability in arbitration and that the federal courts are incapable of intervening to remedy even a pervasive series of arbitral abuses.

Review is urgently needed, lest more parties conclude that the Ninth Circuit's approach – and the even more aloof approaches of the First, Fifth, Eighth, and Eleventh Circuits – make the risks of arbitration too great to accept.

C. The Ninth Circuit Took An Unduly Narrow View Of The Circumstances Under Which An Arbitration Award May Be Vacated.

1. This case provides an excellent vehicle for resolving the conflict and determining the statutory and jurisprudential basis for reviewing aberrant arbitration awards. The Ninth Circuit correctly held that the doctrines of "manifest disregard of the law" and "complete irrationality" survive *Hall Street*. App. 9a-10a. But the court's extremely chary conception of those doctrines (*ibid.*) both deepens the divide among the courts of appeals and conflicts with the actual language of Section 10.

As this Court implied in *Hall Street*, "the § 10 grounds collectively" may create a penumbra that encompasses such long-standing bases for vacatur as "manifest disregard of the law" and "complete irrationality." 552 U.S. at 585. The provisions of Section 10, individually, authorize vacatur upon a showing that

- the award was "procured by corruption, fraud, or *undue means*" (§ 10(a)(1));
- there was "*evident partiality or corruption*" on the part of the arbitrators (§ 10(a)(2));
- the arbitrators engaged in "*misbehavior*" that prejudiced one of the parties (§ 10(a)(3)); or

- the arbitrators "*exceeded their powers*" under the arbitration agreement or so imperfectly executed those powers as to render the resulting award inherently defective (§ 10(a)(4)). (Emphases added)

Together, these enumerated grounds reflect that Section 10 was meant as a safeguard against the possibility of a fundamental breakdown in the adjudicative process itself – *i.e.*, conduct by the arbitrators that effectively deprives the parties of the fair and neutral arbitration for which they contracted.

2. As the Second Circuit has explained, the "manifest disregard of the law" standard is intended to address "'those exceedingly rare instances' of 'egregious impropriety on the part of the arbitrators.'" *Stolt-Nielsen*, 548 F.3d at 95 (quoting *Duferco Int'l Steel Trading* v. *T. Klaveness Shipping A/S*, 333 F.3d 388, 389 (2d Cir. 2003)). It is "a mechanism to enforce the parties' agreements to arbitrate" and is not the equivalent of unauthorized "judicial review" of the arbitrators' decision. *Ibid.*; *cf. Hines* v. *Anchor Motor Freight, Inc.*, 424 U.S. 554, 567 (1976) (review of merits allowed where conduct "seriously undermines the integrity of the arbitral process"); *id.* at 571 ("Congress ... anticipated, we are sure, that the contractual machinery would operate within some minimum levels of integrity.").

That court's 2007 decision in *Porzig* is illustrative of this process-protecting review. There, the court vacated an award based on a *pattern* of legal and factual irregularities, explaining:

> "Taken individually, in all likelihood, such circumstances would not have overcome the deference owed to the Panel's award. Taken

> together, however these circumstances create, if not the perfect storm, then a disturbance ample enough to give us pause." 497 F.3d at 140.

Applying a "totality of the circumstances" test, the Second Circuit vacated the award.

Here, just as in *Porzig*, the district court conducted a comprehensive assessment of the arbitration process and found that it had gone fundamentally wrong. The court explained that its decision to vacate the awards was based on several factors, including the irrational finding that Lagstein was "totally disabled," as the insurance policy required; the "total size of the award," which "shocks the Court's conscience" and "is biased"; and Whitehead's and Springer's disregard for the limits the parties placed on their jurisdiction by express agreement. App. 25a. Mirroring the *Porzig* methodology, the district court concluded: "Taken together, the size and scope of the awards shock the Court's conscience and contravene public policy. They must be overturned." *Ibid.*

In reversing, the Ninth Circuit missed the forest for the trees. It asked simply whether, ***viewed in isolation from each other***, particular errors in the arbitration awards satisfied the court's narrow conception of "manifest disregard." That limited conception focuses on only a single inquiry: Did the arbitrators recognize a particular, controlling rule of law and deliberately flout it? App. 7a-12a. That myopic focus is not faithful to the essential premises of voluntary arbitration, which Section 10 was designed to have the courts enforce.

3. Indeed, the factors that "shocked" the district court, which caused it to conclude that the presumption of validity had been overcome, raise a compelling inference of "bias," "misbehavior," and "excess of powers." Review for "irrationality," as the district court concluded, is a legitimate way to enforce the various, interrelated standards set out in Section 10.

(a) Lagstein's surgeon predicted that Lagstein would make a full recovery and return to work within eight weeks. Consistent with that assessment, Lagstein certified to his hospital that he was fit and ready to work approximately eight weeks after surgery. Lagstein clandestinely returned to work ten weeks after surgery (and 13 days before the earliest date on which he could have received his first benefit payment). Lagstein continued (through the hearing) to work at a multi-million-dollar medical practice. When pressed why he promptly had gone back to work despite his claim of "disability," Lagstein admitted that his job is "easy" and asked, rhetorically, "why shouldn't I do it?" Nevertheless, Whitehead and Springer found that Lagstein was permanently unable to "perform in ***any professional capacity*** within the medical profession." See pages 3-4, *supra*.

(b) Whitehead and Springer based their conclusion that Underwriters breached the contract on what they described as "highly critical" policy language, even though it is undisputed that the relevant language was ***not*** part of Lagstein's policy. See page 6 & n.2, *supra*.

(c) As an alternative basis for awarding the full five years' worth of benefits to Lagstein, Whitehead and Springer concluded that Underwriters violated Nevada Revised Statute § 689A.410(2) by failing to

pay or deny Lagstein's claim within 30 days. App. 48a-49a. In fact, however, that Section expressly exempts insurers from the 30 day-deadline when, as here, the insurer has timely informed the insured of additional information needed to decide the claim. See page 3, *supra*. Thus, the case presents a clear example of "manifest disregard" of law.

(d) Lagstein had promptly returned to work to earn millions of dollars a year performing tasks that he characterized as equivalent to reading the newspaper. See pages 3-4, *supra*. Nevertheless, Whitehead and Springer concluded that Underwriters' handling of his claim had caused him "emotional distress" – and awarded $1,500,000 for this alleged "distress," a figure the district court concluded had "no support in the record" and "comes out of space." App.31a-32a.

(e) They then imposed $4,000,000 in punitive damages, an amount deemed conscience-shocking by the district court. But Lagstein's only witness at the punitive-damages hearing acknowledged that the lead syndicate on Lagstein's policy (which handled the claim) has an outstanding reputation for paying claims (DER603-07); other witnesses confirmed that the syndicate had never before been held liable for breach of insurance contract, much less bad faith or punitive damages (DER631-32).

4. The Ninth Circuit was plainly uncomfortable with the array of errors on which the awards rested, but pronounced the courts impotent to respond. In addressing the fundamental issue whether Lagstein was "totally disabled" and thus entitled to benefits, even though he actually had returned to his lucrative job promptly after surgery, the court shrugged: "Whether or not the panel's findings are supported

by the evidence in the record is beyond the scope of our review." App. 11a (internal quotation marks omitted).

It also disregarded the majority's reliance on a facially inapplicable policy provision, concluding that the "fact that the majority may have made a mistake in citing a benefit that Lagstein had not purchased does not establish irrationality of its ultimate conclusion that Lloyd's breached its contract," because "[t]he majority provided several independent reasons for finding a breach of contract." App. 11a. For that excuse, the court cited the majority's (mis)reading of Nevada Revised Statute § 689A.410(2), (App. 48a-49a) even though that statute manifestly does ***not*** support the award.

Finally, the court held that the district court "erred in concluding that the size of the arbitration awards demonstrated manifest disregard of the law." The Ninth Circuit held that, as a matter of law, the "manifest disregard" doctrine applies only when it is "clear from the record that the arbitrators recognized the applicable law and then ignored it" (App. 9a). That narrow and exclusive focus, however, would require a reviewing court to enforce even a billion-dollar punitive award here, except in a highly implausible scenario in which arbitrators brazenly confess their decision to flout a particular legal duty. The FAA simply cannot command federal courts to enforce arbitral awards in such circumstances. There is no evidence that Congress intended that the general language of the vacatur standards in Section 10 must be construed to hamstring reviewing courts so severely.

II. The Court Should Make Clear That Arbitrators Have An Affirmative Duty To Disclose Material Information Bearing On Their Integrity And Independence.

A. The Courts Of Appeals Are Divided Over The Scope Of Disclosure Required Under The FAA.

1. For parties to make an informed judgment whether to appoint particular candidates to arbitrate their disputes, they must have enough information about the candidates to evaluate their competence, independence, and neutrality. The FAA presupposes that the candidates will take the initiative to supply this information.

Thus, over forty years ago, this Court held that the FAA imposes the "simple requirement" that arbitrators must "disclose to the parties ***any*** dealings that ***might create an impression*** of possible bias." *Commonwealth Coatings Corp.* v. *Cont'l Cas. Co.*, 393 U.S. 145, 149 (1968) (emphasis added). Accordingly, in order to protect the integrity of the process for selecting arbitrators, the Court held that Section 10 requires vacatur of any award issued by an arbitrator who violated a disclosure obligation. *Ibid.*

During the ensuing decades, however, the courts of appeals have expressed divergent views regarding the scope of disclosures required under the FAA. Recognizing that disclosures are a critical component of the arbitration process, some have taken a comparatively broad view of the disclosure obligation. See, *e.g.*, *Olson* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 51 F.3d 157, 159-160 (8th Cir. 1995); *Morelite Constr. Corp.* v. *New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 81, 84 (2d

Cir. 1984); *Middlesex Mut. Ins. Co.* v. *Levine*, 675 F.2d 1197, 1199-1202 (11th Cir. 1982) (per curiam).

Others have taken a much narrower approach, effectively imposing a burden of investigation on the parties except with respect to certain limited categories of information. See, *e.g.*, *Positive Software Solutions, Inc.* v. *New Century Mortgage Corp.*, 476 F.3d 278, 283-85 (5th Cir. 2007) (en banc); *Winfrey* v. *Simmons Foods, Inc.*, 495 F.3d 549, 552 (8th Cir. 2007); *ANR Coal Co.* v. *Cogenetrix of N.C, Inc.*, 173 F.3d 493, 500 (4th Cir. 1999); *Merit Ins. Co.* v. *Leatherby Ins. Co.*, 714 F.2d 673, 678-679 (7th Cir. 1983).

2. The decision below falls within the latter camp. The Ninth Circuit held that arbitrators have no obligation to disclose information bearing on their integrity or independence, unless that information can be tied directly *to their relationships with the parties to the dispute or their counsel.* No other information bearing on their competence, integrity, or independence need be disclosed. If the parties and their counsel want to know more, they must undertake their own independent investigation – of unspecified intensity and expense – in order to ferret out that additional, material information. Thus, the Ninth Circuit has opted for the most circumscribed standard of disclosure possible.

The present case both adds to the confusion in the courts of appeals and constitutes an ideal vehicle for resolving that confusion.

B. The Ninth Circuit Took An Unduly Narrow View Of Arbitrators' Disclosure Obligation Under The FAA.

1. This Court in *Commonwealth Coatings* characterized a potential arbitrator's disclosure obliga-

tion under the FAA as "broad." 393 U.S. at 148. To give content to that "broad" language, the Court invoked two types of external standards. First, it noted that the AAA Rules and the AAA/American Bar Association Code of Ethics for Arbitrators are "highly significant" when interpreting the disclosures that are required under the FAA. *Id.* at 149. Second, it relied on the canons of judicial ethics to create a floor for arbitral disclosures, noting that the consensual nature of arbitration and the limited nature of appellate review dictate arbitral disclosures that go beyond those required of judges. *Id.* at 148-149 ("we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges").

The Ninth Circuit's narrow view of arbitrators' disclosure obligations cannot be squared with this Court's direction to find enforceable standards in the AAA Rules and the canons of arbitrator ethics.

The AAA Rules require potential arbitrators to disclose "*[a]ny circumstance* likely to give rise to justifiable doubt as to the arbitrator's impartiality ***or independence***." AAA Rule R-16(a) (emphasis added).

The AAA/ABA Code of Ethics for Arbitrators implements this general directive by specifically requiring disclosure of "any known existing or past financial, business, *professional or personal relationships* which might reasonably affect impartiality ***or lack of independence*** in the eyes of any of the parties," including "any such ***relationships ... with any co-arbitrator***." *AAA/ABA Code of Ethics for Arbitrators*, Canon II(A)(2) (emphasis added).

Similarly, applicable Nevada law expressly required that potential arbitrators "shall disclose ... any known facts that a reasonable person would consider likely to affect the impartiality of the arbitrator in the proceeding, ***including ... (b) An existing or past relationship with ... another arbitrator***." Nev. Rev. Stat. § 38.227(1) (emphasis added).

Thus, these "highly significant" sources require potential arbitrators to disclose their relationships *with each other*, not just with the parties and the parties' attorneys, as the Ninth Circuit held. As the eventual voting pattern here illustrated, it was certainly material for both arbitrators to have disclosed that they had been closely aligned personally and professionally – and improperly – during the investigations into Whitehead's judicial misconduct. Disclosure of that relationship would have flagged the risk that his compatriot, Springer, would tend to line up with Whitehead, who was Lagstein's chosen arbitrator, rather than to serve as a truly "independent" decision-maker as the governing rules and ethics standards required.

2. The Ninth Circuit's overly narrow reading of the disclosure obligation under the FAA is even more obviously unsound when, as here, the parties have contracted for more stringent disclosures. As this Court repeatedly has stated, "the central or 'primary' purpose of the FAA, is to ensure that private agreements to arbitrate are enforced according to their terms." *Stolt-Nielsen*, 130 S. Ct. at 1773 (internal quotation marks omitted). Here, and in hundreds of thousands of other arbitrations every year, the rules of the AAA (or other arbitration service providers) are not just "highly significant," but are binding. DER286.

Under Section 5 of the FAA, that contractual agreement to conduct an arbitration according to the AAA Rules has legal force:

> "If in the [arbitration] agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed." 9 U.S.C. § 5.

Thus, when the parties contract to have their arbitration conducted according to AAA Rules (including the cognate AAA/ABA ethics rules, which apply to all arbitrations), those standards establish the "method" by which the parties are entitled to screen potential arbitrators. To make an informed judgment about the candidates, the parties are entitled to receive disclosures satisfying the governing standards. When the candidates fail to make disclosures that the parties had agreed must be made, they have frustrated the parties' mandatory "method" of selecting arbitrators. That failure constitutes "misconduct" or "misbehavior," which are explicit grounds for vacatur under Section 10(a)(3).

By failing to enforce the broader disclosure obligations that bound the arbitrators here, the Ninth Circuit has rendered this critical aspect of hundreds of thousands of arbitration agreements meaningless.

3. The Ninth Circuit's approach also ignored another statutory basis for broader disclosure. Section 10(a)(2) requires a court to vacate an award where there is "evident partiality." Underwriters argued that Whitehead's failure to disclose his non-prosecution agreement and Springer's failure to disclose his controversial alignment with Whitehead during the scandal were indicative of "evident parti-

ality or corruption" necessitating vacatur under Section 10(a)(2) and *Commonwealth Coatings*.

The Ninth Circuit concluded that there was no direct link between Whitehead's non-prosecution agreement and either of the parties or between the Whitehead/Springer relationship and the instant dispute. Therefore, the court concluded that they did not have to disclose these facts in order to dissipate an inference of "evident partiality." According to the Ninth Circuit, if Underwriters wanted to know "additional information about the arbitrators' backgrounds, it was free to seek that information by its own efforts." App. 20a.

The court took the same view of the "evident corruption" prong of Section 10(a)(2), stating: "[Underwriters'] evidence of alleged corruption at some time in the past does not relate to this case or the parties to it, nor does it raise a 'reasonable impression of corruption' in the present case." *Ibid.*

Read as a whole, however, as it must be, the statutory phrase "evident partiality or corruption" is broad enough to encompass any fact that would lead a reasonable observer to question whether the proposed arbitrator can be both fair and independent. The dictionary definition of "corruption" is "impairment of integrity, virtue, or moral principle." Merriam-Webster Online Dictionary, at http://www.merriam-webster.com/dictionary/corruption. A non-prosecution agreement certainly bears on that fundamental question, particularly one arising out of the subject's abuses of judicial power. Nothing in the statutory language suggests that arbitrators are free to conceal such information so long as it does not relate *directly* to the parties or the dispute.

More fundamentally, *Commonwealth Coatings* rejected the assertion that Section 10(a)(2) allows vacatur only upon proof that the arbitrator would financially benefit – corruptly – by ruling for one of the parties. Instead, the Court relied on this standard as a prophylactic disclosure standard *to give the parties confidence* that the arbitrator will be able to act fairly, capably, and independently. As the Court said, Congress expected "strict morality and fairness" from arbitrators, and the broad, pre-arbitration disclosure standard is designed to offer this assurance. 393 U.S. at 148; *cf. Hines*, 424 U.S. at 571.

By contrast, the Ninth Circuit's holding that arbitrators have no obligation to disclose information regarding their integrity and independence cannot be squared with this Court's view. Indeed, information about a candidate's checkered judicial past or his alliance with a co-arbitrator may well be ***more*** important to a party than the two, limited categories of relationships that the Ninth Circuit deemed to be the exclusive concern of Section 10(a)(2).

C. Strong Disclosure Requirements Are Critically Important To The Integrity And Acceptability Of Arbitration.

1. The parties' right to make an informed choice of their arbitrators, based on candid disclosure of material information, is a core premise of arbitration. Indeed, it is critical to the entire FAA framework precisely because judicial review of the actions of an arbitrator, once appointed, is so limited. Requiring "arbitrators [to] err on the side of disclosure" promotes "the public interest in efficient and final arbitration," because the "arbitration process functions best" when full disclosure by the arbitrators fosters "an amicable and trusting atmosphere" con-

ducive to "voluntary compliance with the decree." *Commonwealth Coatings*, 393 U.S. at 151-152 (White, J., concurring).

2. The Ninth Circuit has turned this principle on its head, creating a regime that allows arbitrators to conceal information from the parties and places the burden on each party to ferret out what the arbitrators might be hiding, lest the party be irrevocably saddled with a rogue arbitrator or a furtive cabal of co-arbitrators. App. 18a-20a.

For example, if Whitehead (the arbitrator whom Lagstein proposed for this very profitable engagement), had disclosed his history with Springer (the person Whitehead suggested to serve as the third arbitrator and chairman), Underwriters would have had good reason to doubt their ability to act with true independence. Independence is one of the core values that parties expect from co-arbitrators. See *AAA/ABA Code of Ethics for Arbitrators*, Canon II(A)(2). Underwriters was entitled to *three independent* arbitrators, independent not only from the adverse party but from each other. That is why the applicable rules (and indeed the Nevada statute) expressly require disclosure of relationships *with other arbitrators*.

This case graphically illustrates the importance of having arbitrators who are independent of each other. Whitehead and Springer acted in lockstep on myriad rulings, which in the aggregate the district court deemed to be shocking and suggestive of bias (App. 25a, 28a-34a) and which the Ninth Circuit either acknowledged to be wrong (App. 11a ("the majority may have made a mistake")) or found, at best, merely "plausible" (App. 9a-17a).

It goes without saying that a party informed of Whitehead's non-prosecution agreement (and the charges of judicial misconduct, abuse of power, and favoritism leading to enforced resignation from the bench) might reasonably question his capacity to maintain an attitude of impartiality or independence. What reasonable party, armed with such disclosure, would confidently accept such a decision-maker nominated by the adverse party and comfortably assume that he would receive a fair shake from the adversary's nominee (especially when eventually paired with a close ally)? Indeed, if a party in Underwriters' position had been informed of the forced resignation under threat of prosecution, the party might reasonably doubt the nominee's basic judicial temperament and trustworthiness. That was evidently the federal government's judgment when it made a lifetime ban on judicial service one of the conditions of dropping its threatened prosecution.

The Ninth Circuit's decision establishes that parties have no right to expect – and no enforceable right to demand – disclosures necessary to ensure that they are not ceding authority to individuals whom they would not trust, if they knew the facts. The message to arbitrators is that, far from "err[ing] on the side of disclosure, as they should" (*Commonwealth Coatings*, 393 U.S. at 152 (White, J., concurring)), they can obtain lucrative engagements by concealing information bearing on their integrity and independence and hope that no one finds them out in time. Review is warranted to rectify this dramatic and deleterious deviation from the "broad" view of disclosure announced in *Commonwealth Coatings*.

III. The Court Should Make Clear That Arbitrators "Exceed Their Powers" When They Disregard The Parties' Agreements Governing Arbitration Procedures, Including The Time Limits On Issuing Any Award.

A third aspect of the Ninth Circuit's ruling warrants review: its decision that arbitrators are not bound to observe the limits that the parties impose on their powers.

A. The Ninth Circuit's Holding Conflicts With A Consistent Line Of Decisions From This Court.

1. Rule R-41 of the AAA's Rules, which the parties' contract made applicable here, provides that an arbitration award "*shall be made* promptly by the arbitrator and, unless otherwise agreed by the parties or specified by law, *no later than 30 days from the date of closing the hearing*." DER241 (emphasis added).

At the close of the hearing here, arbitrator Williams stated:

> "We will treat this matter as submitted today at the close of argument. Under AAA rules, a decision *is required generally within 30 days* ... we would solicit a stipulation from Counsel that *we may produce an award on or about September 1st 2006*, a 15 day extension." DER598-99 (emphasis added).

The parties stipulated that the award could be returned as late as September 1, 2006, and chairman Springer declared that "[t]he matter will stand submitted." *Ibid.*

On September 1, Whitehead and Springer issued an award holding that Underwriters had breached the "disability insurance" contract, assessing damages for "lost" benefits and "emotional distress." They also decided that Underwriters should be socked with punitive damages, but they did not include such an assessment in the award. Instead, without further agreement by the parties to extend the deadline for issuing their final award, they ordered the parties to attend a second hearing, months later, devoted only to the amount of punitive damages. App. 108a. Underwriters attended that hearing under protest. DER193-202. In his dissent from the ensuing punitive award, arbitrator Williams concluded that "the Arbitration Panel's jurisdiction terminated with the Award and Dissent filed on September 1, 2006." App. 158a-160a.

2. The district court agreed that Whitehead and Springer "exceeded [their] powers in ... retaining jurisdiction to enter [an] untimely punitive damages award[]" months after the parties' agreed deadline for arbitral action. App. 25a.

The Ninth Circuit, however, held that the arbitrators have effectively unreviewable discretion to ignore even this explicitly agreed-upon end-date for the arbitration. App. 12a-17a. The court reasoned that (i) the "question of the time frame within which an arbitration panel may issue an award is a procedural matter"; (ii) the arbitrators' interpretation of procedural matters is entitled to the same near-total deference under the FAA as their decision on the merits; and (iii) Whitehead and Springer offered "plausible" rationales for scheduling additional hearings and extending the time within which they were authorized to act. App. 14a-17a.

3. The Ninth's Circuit's holding is irreconcilable with this Court's precedents insisting that arbitration is purely a matter of contract and that the arbitrators have only those powers that the parties agree to confer on them. Thus, "an arbitrator derives his or her powers from the parties' agreement" and the "parties are generally free to structure their arbitration agreements as they see fit ... and may agree on rules under which any arbitration will proceed." *Stolt-Nielsen*, 130 S. Ct. at 1774 (internal quotation marks omitted); see also, *e.g.*, *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985); *United Steelworkers* v. *Enter. Wheel & Car Corp.*, 363 U.S. 593, 597 (1960).

In the most recent case, *Stolt-Nielsen*, the Court held just last Term that an arbitration panel "exceeded its powers" so that its award had to be vacated under Section 10(a)(4). The Court explained that, although the arbitrators were purportedly endeavoring to ascertain the parties' intention, the parties' agreement "left no room for an inquiry regarding the parties' intent." 130 S. Ct. at 1770.

Here, responding to the time limit set in the AAA Rules, which called for the arbitrators to issue an award within 30 days after the close of the hearing, the parties stipulated, at the panel's request, that the panel could have until September 1 – but only until September 1 – to issue an award. Just as in *Stolt-Nielsen*, the parties' stipulation regarding the time for issuing the award "left no room for an inquiry" regarding the time limit on the arbitrators' authority, and "any inquiry into that settled question would have been outside the panel's assigned task." *Ibid.* (internal quotation marks omitted).

B. Unless Overturned, The Ninth Circuit's Holding Will Have Serious Deleterious Consequences.

1. Under the Ninth Circuit's policy, control over the arbitration process passes from the parties to the arbitrators the moment that the arbitrators are appointed. The only limit on their authority is that they must be able to invent a "plausible" rationale for overriding the parties' agreement.

By effectively ceding control over the arbitration process to the arbitrators, and thereby denying parties the ability to establish the rules under which the arbitration will proceed, the Ninth Circuit has created a legal framework that "is fundamentally at war with the foundational FAA principle that arbitration is a matter of consent." *Stolt-Nielsen*, 130 S. Ct. at 1775.

2. The parties' right to establish the ground rules for their arbitration, including deadlines for resolving the case, is an important device for controlling the cost of litigation, which is supposed to be one of the key advantages of arbitration. The parties' loss of control over the procedures for the arbitration translates directly into a loss of control over the costs of adjudication.

For example, in this arbitration the parties and the arbitrators originally set a four-day hearing. The parties were free to (and did) structure their individual presentation of evidence to cover all issues in the case within that agreed-upon time frame. The arbitrators distorted that agreed-upon framework by ordering the parties to present another two days of evidence solely on the amount of punitive damages.

This meant that the arbitrators expanded the agreed-upon process by one-third.

Moreover, when Whitehead and Springer took it upon themselves to change the length of the arbitration from four days to six days and to extend their post-hearing jurisdiction from the agreed-upon 45 days to an undefined term that dragged out to 149 days, they dramatically increased their own fees, effectively awarding themselves a "bonus" of 50 to 100 percent by increasing the hours for which they eventually billed. They also forced the parties to bear commensurate increases in their attorneys' fees, witness preparation and attendance costs, transcript preparation costs, and so on.

The dollar amount of these additional costs here reaches into six figures. But there is nothing in the Ninth Circuit's framework that would prevent arbitrators from making unilateral decisions that would cost the parties millions of dollars (while adding hundreds of thousands of dollars to the arbitrators' coffers in the form of continuously accruing fees).

As it stands, the Ninth Circuit has placed parties entirely at the mercy of the individuals they hire to arbitrate a dispute. Stripped of the ability to shape the arbitration to their needs and to control their costs, parties will be significantly less apt to consider arbitration to be a viable alternative to litigation.

As we have noted, thousands of disputes are arbitrated annually under the AAA Rules. All of the parties to these disputes, along with the arbitrators who are handling them, deserve to know whether the FAA allows the federal courts to enforce the procedural limits on which the parties have agreed. The undesirable alternative is to leave in place the Ninth

Circuit's rule that an arbitrator's "plausible" ability to characterize the limits as "procedural" prevents the courts from intervening.

Congress has expressly authorized the courts to vacate awards when arbitrators "exceed[] their powers." 9 U.S.C. § 10(a)(4). It is extremely important that this Court determine how far arbitrators may go to side-step the limits the parties have placed on those powers.

CONCLUSION

The petition for a writ of certiorari should be granted and the case set for full briefing and oral argument.

In the alternative, the Court should reverse summarily to the extent that the Ninth Circuit upheld the second award, which assessed punitive damages, as "exceed[ing] the powers" of the arbitrators in violation of Section 10(a)(4) of the FAA.

Respectfully submitted.

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OCTOBER 2010

APPENDICES

APPENDIX A

FOR PUBLICATION
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT
ZEV LAGSTEIN, M.D.,
Plaintiff-Appellant,
v.
CERTAIN UNDERWRITERS AT LLOYD'S, LONDON,
Defendant-Appellee.
No. 07-16094
D.C. No.
CV-03-01075 RCJ

OPINION

Appeal from the United States District Court for the District of Nevada Robert C. Jones, District Judge, Presiding

Argued and Submitted November 3, 2009 – San Francisco, California

Filed June 10, 2010

Before: Betty B. Fletcher, William C. Canby, Jr., and Susan P. Graber, Circuit Judges.

Opinion by Judge Canby

COUNSEL

Thomas L. Hudson, Osborn Maledon, P.A., Phoenix, Arizona, for the plaintiff-appellant.

Evan M. Tager, Mayer Brown LLP, Washington, D.C., for the defendant-appellee.

OPINION

CANBY, Circuit Judge:

After developing heart disease and other ailments, Zev Lagstein, M.D., filed with Certain Underwriters at Lloyd's, London ("Lloyd's") a claim for benefits under a disability policy. After nearly two years passed without a decision on the claim, Lagstein sued Lloyd's in federal court. The case was stayed pending binding arbitration mandated by Lagstein's policy. The majority of a three-member arbitration panel found in favor of Lagstein, awarding him full policy benefits, emotional distress damages, and punitive damages, all of which totaled more than six million dollars. The district court vacated the overall award on the ground of its excessive size and vacated the punitive damages award on the additional ground that the arbitration panel lacked jurisdiction to enter it after the panel had entered its compensatory award. We reverse the district court's vacatur of the awards. We agree, however, with the district court's ruling that Lloyd's did not establish partiality of two of the arbitrators as an additional ground of vacatur.

BACKGROUND

Appellant Lagstein is a cardiologist and disability examiner. In 1999, he obtained an insurance policy from Appellee Lloyd's in which Lloyd's agreed to pay Lagstein $15,000 per month for up to sixty months in the event that Lagstein became unable to practice medicine due to disability. In 2001, Lagstein developed heart disease, as well as severe migraine headaches and other neurological problems. Several physicians who examined Lagstein concluded that he was permanently disabled from practicing medicine.

Lagstein then submitted to Lloyd's a claim for benefits under the disability policy.

Because Lagstein had received no benefits or even a decision on his claim by early 2002, he went back to work against the advice of his doctors. Relations between the parties increasingly soured, and each accuses the other of delay and bad faith in the months that followed. In September 2003, still having received no decision on his claim,[1] Lagstein filed a complaint in the United States District Court for the District of Nevada for breach of contract, breach of the covenant of good faith and fair dealing, and unfair trade practices. Upon Lloyd's motion, the district court stayed the lawsuit pending binding arbitration required by Lagstein's policy.

As provided in Lagstein's policy, each party appointed an arbitrator and those two arbitrators appointed a third. Lagstein selected Jerry Carr Whitehead, Lloyd's selected Ralph O. Williams, III, and Whitehead and Williams together appointed Charles Springer. Each of the arbitrators submitted a disclosure statement to the parties setting forth prior relationships with the parties, the parties' attorneys, and those attorneys' law firms.

The initial arbitration hearing was held from July 11 to July 14, 2006, and the panel issued a decision on August 31, 2006. All three arbitrators concluded that Lloyd's breached the insurance contract and acted unreasonably, but the panel split on the amount of damages to be awarded. The majority, formed by Springer and Whitehead, concluded that

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[1] Lloyd's finally denied Lagstein's claim on July 29, 2005, approximately three and a half years after the claim was filed.

Lagstein should be awarded the full value of his policy, $900,000, as well as $1,500,000 for emotional distress. The majority also concluded that punitive damages were warranted, but ordered that the amount be determined at a separate hearing.

The dissenting arbitrator, Williams, would have awarded Lagstein only $11,000 under his policy and no emotional distress damages or punitive damages. The disagreement between the majority and the dissent turned on whether the evidence showed that Lagstein remained disabled from practicing medicine after he returned to work, whether Lagstein proffered sufficient evidence of emotional distress, and the significance of delays in Lloyd's handling of the claim that were attributable to Lagstein himself.

The punitive damages hearing was held on November 20 and 21, 2006, over Lloyd's objection that the panel's jurisdiction had ended once it issued the initial award. The same majority of the panel, after explaining the basis for its continued jurisdiction, awarded Lagstein $4,000,000 in punitive damages. Arbitrator Williams again dissented, arguing that the panel lacked jurisdiction to make the award, and that, even if it had jurisdiction, the award appropriately should have been $50,000.

Following the panel's initial award, Lloyd's investigated the backgrounds of arbitrators Springer and Whitehead and discovered their roles in a controversy that had occurred over a decade earlier. In 1993, Whitehead, who at the time was a Nevada trial judge, became involved in an ethics controversy arising from his handling of peremptory strikes entered against him under Nevada's rule for peremptory striking of judges. The Nevada Commission on Judicial Discipline filed a complaint alleging that on sev-

eral occasions Whitehead, through *ex parte* contacts, permitted counsel for the non-challenging party to select a replacement judge. Although the Commission's complaint against Whitehead eventually was dropped, the FBI subsequently investigated Whitehead on unspecified charges. Whitehead ultimately signed a non-prosecution agreement conditioned on his retiring from the bench, agreeing not to seek reelection, and agreeing not to serve again in "any state judicial capacity."

In the meantime, a related controversy erupted over the Commission's procedures and jurisdiction in the Whitehead investigation. These matters were addressed by an increasingly divided Nevada Supreme Court over the course of several decisions.[2] Arbitrator Springer was a member of the Nevada Supreme Court at the time and consistently sided with Whitehead on these procedural and jurisdictional issues. *See, e.g.*, *Whitehead IV*, 893 P.2d at 941-65 (Springer, J., concurring).

Lloyd's filed in the district court a motion to vacate the arbitration awards on several grounds, including Springer's and Whitehead's failure to disclose the prior ethics controversy, as well as the majority's decision to hold a separate punitive damages

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[2] *See Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 869 P.2d 795 (Nev. 1994), *amended by* 906 P.2d 230 (Nev. 1994) ("*Whitehead I*"); *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 873 P.2d 946 (Nev. 1994) ("*Whitehead II*"); *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 878 P.2d 913 (Nev. 1994) ("*Whitehead III*"); *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 893 P.2d 866 (Nev. 1995) ("*Whitehead IV*"); *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 908 P.2d 219 (Nev. 1995) ("*Whitehead V*"); *Whitehead* v. *Nev. Comm'n on Judicial Discipline*, 920 P.2d 491 (Nev. 1996) ("*Whitehead VI*").

hearing after the issuance of the initial award. Following a hearing on the matter, the district court vacated the awards, concluding that the size of the awards was excessive and in manifest disregard of the law, and that the punitive damages award contravened public policy and exceeded the panel's jurisdiction. The district court concluded, however, that vacatur was not independently warranted by Springer's and Whitehead's non-disclosure of the prior controversy.

Lagstein appeals the district court's vacatur of the arbitration awards. We have jurisdiction pursuant to 28 U.S.C. § 1291, and we reverse.

DISCUSSION

We review de novo the district court's vacatur of an arbitration award. *New Regency Prods., Inc.* v. *Nippon Herald Films, Inc.*, 501 F.3d 1101, 1105 (9th Cir. 2007). "Our review is limited by the Federal Arbitration Act ('FAA'), which 'enumerates limited grounds on which a federal court may vacate, modify, or correct an arbitral award.' " *Bosack* v. *Soward*, 586 F.3d 1096, 1102 (9th Cir. 2009) (quoting *Kyocera Corp.* v. *Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2003) (en banc)), *cert. denied*, 130 S. Ct. 1522 (2010). Section 10(a) of the FAA permits a district court to vacate an arbitration award under only four circumstances:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing,

> upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a). Unless the award is vacated as provided in § 10, or modified as provided in § 11 (not in issue here),[3] "confirmation is required even in the face of erroneous findings of fact or misinterpretations of law." *Kyocera*, 341 F.3d at 997 (citation and internal quotation marks omitted); see *Hall St. Assocs., L.L.C.* v. *Mattel, Inc.*, 552 U.S. 576, 584 (2008) (holding that §§ 10 and 11 "provide the FAA's exclusive grounds for expedited vacatur and modification").

A

The district court's first ground for vacating the arbitration awards was the awards' total size. As the district court explained, the amount of the awards "shock[ed] the Court's conscience," suggested bias, was unsupported by the record, manifestly disregarded the law, and contravened public policy. Lag-

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[3] Section 11 provides that a court may modify or correct an award when (a) there is an evident miscalculation of figures or mistake in description; (b) the arbitrators have awarded on a matter not submitted to them; or (c) the award is imperfect in a matter of form not affecting the merits of the controversy. 9 U.S.C. § 11. Neither party here has invoked § 11.

stein argues that none of these reasons justified the awards' vacatur. We agree.

A district court may not vacate an arbitration award simply because the court disagrees with its size. The heart of such disagreement concerns the panel's weighing of the evidence, here, on matters such as the length and severity of Lagstein's disability and the egregiousness of Lloyd's conduct. But § 10 of the FAA "does not sanction judicial review of the merits," *Collins* v. *D.R. Horton, Inc.*, 505 F.3d 874, 879 (9th Cir. 2007), and "[w]hether or not the panel's findings are supported by the evidence in the record is beyond the scope of our review," *Bosack*, 586 F.3d at 1105. Thus, it was error for the district court to vacate the arbitration awards simply because it found the total size either shocking or unsupported by the record.[4]

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[4] We also find that the district court's conclusions that the total size of the award contravened public policy and showed bias are without support. First, we note that mere inconsistency with a court's generalized view of public policy is not an appropriate ground for vacatur of an arbitration award, and Lloyd's does not attempt to defend this basis for vacatur on appeal. *See Stead Motors of Walnut Creek* v. *Auto. Machinists Lodge No. 1173*, 886 F.2d 1200, 1212-13 (9th Cir. 1989) (en banc) (holding that, to vacate an award on public policy grounds, "[a] court must both delineate an overriding public policy rooted in something more than general considerations of supposed public interests, and, of equal significance, it must demonstrate that the policy is one that specifically militates against the relief ordered by the arbitrator.") (internal quotation marks and citation omitted). Second, although an award may be vacated "where there was evident partiality ... in the arbitrators," 9 U.S.C. § 10(a)(2), the district court concluded that Lloyd's failed to show that the arbitrators were partial to Lagstein. Thus, the district court's statement that the award "is biased" is puzzling.

Nonetheless, Lloyd's argues that vacatur was proper because the arbitration awards manifestly disregarded the law and were completely irrational. Section 10 permits vacatur "where the arbitrators exceeded their powers." 9 U.S.C. § 10(a)(4). This is a high standard for vacatur; "[i]t is not enough ... to show that the panel committed an error – or even a serious error." *Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1767 (2010). "[A]rbitrators 'exceed their powers' ... not when they merely interpret or apply the governing law incorrectly, but when the award is 'completely irrational,' or exhibits a 'manifest disregard of law.'" *Kyocera*, 341 F.3d at 997 (citations omitted). We conclude that neither excess occurred in this case.

First, the district court erred in concluding that the size of the arbitration awards demonstrated manifest disregard of the law.[5] " 'Manifest disregard of the law' means something more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law." *Mich. Mut. Ins. Co.* v. *Unigard Sec. Ins. Co.*, 44 F.3d 826, 832 (9th Cir. 1995). To vacate an arbitration award on this ground, "[i]t must be clear from the record that the arbitrators recognized the applicable law and then ignored it." *Id.*; *see, e.g., Comedy Club, Inc.* v. *Improv W. Assocs.*, 553 F.3d 1277, 1293 (9th Cir.), *cert. denied*, 130 S. Ct. 145 (2009). Here, the district court

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[5] In *Stolt-Nielsen*, 130 S. Ct. at 1768 n.3, the Supreme Court left open the question whether "manifest disregard" as an independent ground of vacatur survives *Hall Street Associates*, 552 U.S. at 585. Our earlier precedent, however, establishes as the law of our circuit that it does so survive. *Comedy Club, Inc.* v. *Improv W. Assocs.*, 553 F.3d 1277, 1281 (9th Cir.), *cert. denied*, 130 S. Ct. 145 (2009).

found "manifest disregard of the law" without citing any applicable law that the panel recognized and ignored. Similarly, on appeal, Lloyd's does not cite a single Nevada statute or decision pertinent to the size of the arbitration award that the panel manifestly disregarded.

Lloyd's argues, however, that at times "legally dispositive facts are so firmly established that an arbitrator cannot fail to recognize them without manifestly disregarding the law." *Coutee* v. *Barington Capital Group, L.P.*, 336 F.3d 1128, 1133 (9th Cir. 2003). But the facts of Lagstein's continuing disability were hotly contested. The panel's conclusion that Lagstein remained disabled from the practice of medicine after returning to work is not contrary to firmly established legally dispositive facts. Thus, manifest disregard of the law did not provide a basis for vacating the arbitration award.

Lloyd's also attempts to recast the district court's vacatur as an expression that the arbitration awards were "completely irrational." *See, e.g.*, *Kyocera*, 341 F.3d at 997 (citation and quotation marks omitted). An award is completely irrational "only 'where the arbitration decision fails to draw its essence from the agreement.'" *Comedy Club*, 553 F.3d at 1288 (citation and brackets omitted). An arbitration award "draws its essence from the agreement if the award is derived from the agreement, viewed in light of the agreement's language and context, as well as other indications of the parties' intentions." *Bosack*, 586 F.3d at 1106 (citations and internal quotation marks omitted). Lloyd's, however, defends the vacatur of the award on the ground that the awards were irrational in light of the *facts*. For example, Lloyd's argues that it was irrational for the panel to conclude

that Lagstein was totally disabled from practicing medicine when the evidence showed that Lagstein returned to work to complete tasks that he considered "easy." However, "the question is whether the award is 'irrational' with respect to the contract, not whether the panel's findings of fact are correct." *Id.* "Whether or not the panel's findings are supported by the evidence in the record is beyond the scope of our review." *Id.* at 1105.

Further, Lloyd's assertion that the majority misinterpreted certain policy provisions is insufficient to show that the amount of the awards was completely irrational. The fact that the majority may have made a mistake in citing a benefit that Lagstein had not purchased does not establish irrationality of its ultimate conclusion that Lloyd's breached its contract. The majority provided several independent reasons for finding a breach of contract, such as Lloyd's failure to advise Lagstein of the acceptance or denial of his claim within thirty days. This rationale was consistent with applicable Nevada law, *see* Nev. Rev. Stat. § 689A.410, and not inconsistent with the terms of Lagstein's policy.

Equally unavailing is Lloyd's argument that the majority, in concluding that Lloyd's acted in bad faith and repudiated the contract, mistakenly concluded that Lloyd's had violated the policy's "referee provision." This provision required that Lloyd's physician and Lagstein's physician, in the event that they disagreed about whether Lagstein was disabled, choose a third physician to evaluate Lagstein. After such a disagreement arose, Lloyd's hired a third physician of its own choosing to evaluate Lagstein. While Lloyd's claims that the physician was hired to evaluate an entirely different medical condition, so that

the referee provision was inapplicable, the panel majority interpreted the evidence differently, concluding that Lloyd's violated the provision by not informing Lagstein of its applicability. Disagreement over Lloyd's compliance with a policy provision is insufficient to show that the award failed to draw its essence from Lagstein's policy. *See Bosack*, 586 F.3d at 1106 ("We will not vacate an award simply because we might have interpreted the contract differently.").

We conclude, therefore, that the district court's vacatur of the overall awards was not supported by any permissible ground under the Arbitration Act or the controlling decisions interpreting it.

B

The district court also vacated the punitive damages award on the alternative ground that the panel no longer had jurisdiction over the dispute after issuing the initial arbitration award. We conclude that the panel did not exceed its authority because the timing of the arbitration award was a procedural matter committed to the panel's interpretation, and the panel's conclusion that it retained jurisdiction was a plausible construction of the parties' agreement and the procedural rules the agreement incorporated.

Lagstein's policy provided that the arbitration was governed by the commercial arbitration rules of the American Arbitration Association ("AAA"). At issue is Rule R-41, which provides that an award "shall be made promptly by the arbitrator and, unless otherwise agreed by the parties or specified by law, no later than [thirty] days from the date of closing the hearing." Am. Arbitration Ass'n, *Commercial Arbitration Rules and Mediation Procedures*, Rule R-

41 (2005) (hereinafter "CAR"). Upon the close of the initial hearing on July 14, 2006, arbitrator Williams stated that the panel would treat the matter as submitted. He also noted that, "[u]nder the AAA rules, a decision is required generally within 30 days." Because of scheduling concerns, Williams requested a fifteen-day extension for making an award – until September 1, 2006 – which the parties granted.

The panel issued its initial decision on August 31, 2006, awarding compensatory and emotional distress damages. The initial award also specified that a punitive damages hearing would be held at a later date. The parties, however, did not expressly agree to extend the time for making an award past September 1, 2006. Rule R-38 specifies that "the arbitrator may for good cause extend any period of time established by these rules, *except the time for making the award*." CAR, Rule R-38 (emphasis added). Thus, Lloyd's argues that, by holding the punitive damages hearing and then making an award past September 1, 2006, the panel exceeded its jurisdiction. We conclude that Lloyd's is mistaken.

Section 10 of the FAA permits vacatur "where the arbitrators exceeded their powers." 9 U.S.C. § 10(a)(4). A party has "a right to arbitration according to the terms for which it contracted," *W. Employers Ins. Co.* v. *Jefferies & Co.*, 958 F.2d 258, 261 (9th Cir. 1992), and arbitrators exceed their powers for purposes of § 10(a)(4) when they "act outside the scope of the parties' contractual agreement," *Mich. Mut. Ins.*, 44 F.3d at 830; *see Stolt-Nielsen*, 130 S. Ct. at 1772-75. However, "[w]e ... have no authority to vacate an award solely because of an alleged error in contract interpretation." *Employers Ins. of Wausau* v. *Nat'l Union Fire Ins. Co. of Pittsburgh*, 933 F.2d 1481,

1486 (9th Cir. 1991). Instead, "[we] need only determine whether the arbitrators' interpretation was 'plausible.' " *Id.* (citations omitted); *see also McKesson Corp.* v. *Local 150 IBT*, 969 F.2d 831, 834 (9th Cir. 1992).

As a general matter, this narrow standard of review applies to the arbitrator's interpretation of matters of procedure in the contract as well as matters of substance. "In the absence of an express agreement to the contrary, procedural questions are submitted to the arbitrator, either explicitly or implicitly, along with the merits of the dispute." *McKesson*, 969 F.2d at 834; *cf. Schoenduve Corp.* v. *Lucent Techs., Inc.*, 442 F.3d 727, 733 (9th Cir. 2006) (explaining that "the arbitrator's interpretation of the scope of his powers is entitled to the same level of deference as his determination on the merits"). As the Supreme Court has explained, " 'procedural questions which grow out of the dispute and bear on its final disposition' are presumptively not for the judge, but for an arbitrator, to decide." *Stolt-Nielsen*, 130 S. Ct. at 1775 (internal quotation and citation omitted); *see also United Paperworkers Int'l Union, AFL-CIO* v. *Misco, Inc.*, 484 U.S. 29, 40 (1987).

The question of the time frame within which an arbitration panel may issue an award is a procedural matter. *McKesson*, 969 F.2d at 834 ("Courts have uniformly held that limitations on the time in which an arbitrator may render an award are procedural not jurisdictional.").

Nothing in Lagstein's policy or the CAR that it incorporated expressly withdrew determination of procedural issues from the panel. In fact, Rule R-53, which provides that "[t]he arbitrator shall interpret and apply these rules insofar as they relate to the

arbitrator's powers and duties," clearly contemplates that arbitrators will decide the meaning of the CAR's procedural rules. CAR, Rule R-53; *see also Gov't of India* v. *Cargill, Inc. (In re Arbitration No. AAA13-161-0511-85)*, 867 F.2d 130, 134 (2d Cir. 1989) (rejecting a challenge to an arbitration award that was not made within thirty days of the close of hearing because the agreement gave arbitrators authority to interpret the rules).

We also conclude, for two reasons, that the panel plausibly interpreted the arbitration agreement and its governing rules to permit the panel to schedule a hearing beyond September 1, 2006.

First, because the initial award specified that further proceedings would be held to decide the amount of punitive damages, the panel plausibly determined that the initial award constituted an interim award.[6] *See* CAR, Rule R-43(b) (permitting the panel to issue "interim, interlocutory, or partial rulings, orders, and awards," in addition to final awards). Thus, because a final award had not issued, the hearing plausibly could have been reopened under Rule R-36, which provides that "[t]he hearing may be reopened on the arbitrator's initiative ... *at any time before the award is made*." *Id.*, Rule R-36 (emphasis added). Further, while the parties must agree to an extension of time for making the award

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[6] The panel majority pointed out that Nevada law instructs triers of fact first to decide whether punitive damages are warranted and then to hold a subsequent proceeding to determine their amount, *see* Nev. Rev. Stat. § 42.005(3). Although Lloyd's argues that this Nevada bifurcation rule does not apply to arbitration, any misapplication cannot justify vacatur; "such legal ... errors lie far outside the category of conduct embraced by § 10(a)(4)." *Kyocera Corp.*, 341 F.3d at 1003.

"[i]f reopening the hearing would prevent the making of the award within the specific time agreed on by the parties in the contract(s) out of which the controversy has arisen," the panel could have concluded that no such agreement was required in this case. *Id.* The last sentence in Rule R-36 provides that, "[*w*]*hen no specific date is fixed in the contract*, the arbitrator may reopen the hearing and shall have [thirty] days from the closing of the reopened hearing within which to make an award." *Id.* (emphasis added). Lagstein's policy contained "no specific date" by which a final award must be made, and instead simply provided that the CAR would govern the arbitration. Therefore, the panel did not need the agreement of the parties to reopen the hearing and, because the panel issued the final punitive damages award within thirty days of the punitive damages hearing, Rule R-41 was satisfied.[7]

Second, the panel plausibly interpreted the CAR rules to conclude that the punitive damages award could be issued later than September 1, 2006, because the dispute was subject to the AAA's Procedures for Large, Complex Commercial Disputes ("PLCCD"). CAR Rule R-1 provides that "[u]nless the parties agree otherwise, the [PLCCD] shall apply to all cases in which the disclosed claim or counterclaim of any party is at least $500,000." *Id.* Rule R-1. Lagstein's complaint alleged that he was owed $900,000 in total disability benefits, plus emotional distress and punitive damages, and there is no record of an agreement between the parties that the PLCCD would not apply. Thus, under the PLCCD, the arbi-

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[7] The punitive damages hearing was held on November 21 and 22, 2006, and the award issued on December 14, 2006.

trators had authority to "take such steps as they ... deem[ed] necessary or desirable to avoid delay and to achieve a just, speedy and cost-effective resolution." *Id.* Rule L-4. The panel plausibly could have concluded that it would be "necessary or desirable" to determine whether punitive damages were appropriate in the initial award and then hold a separate hearing to determine their amount. To the extent that the application of Rule L-4 conflicted with Rule R-41, Rule L-4 controlled. *See id.*, Rule R-1 (providing that, where the PLCCD apply, other CAR rules apply only to the extent that they do not conflict with PLCCD).

Undoubtedly, reasonable judges and arbitrators could interpret the AAA rules differently from the way that the majority did in this case. We stress that "[w]hether we would find [the majority's] arguments convincing were it up to us to interpret the contract is beside the point." *Berklee Coll. of Music* v. *Berklee Chapter of the Mass. Fed'n of Teachers, Local 4412*, 858 F.2d 31, 34 (1st Cir. 1988) (Breyer, J). Because nothing in the parties' agreement removed the arbitrators' authority to resolve procedural matters, we need only find that the panel's interpretation of the agreement was plausible.[8] Having concluded that this standard was met, we hold that the district court erred in vacating the punitive damages award on the ground that the panel exceeded its authority.

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[8] Our case is to be distinguished from *Stolt-Nielsen*, in which the arbitration panel developed its own common-law rule to be applied to the parties, which had not agreed to it. *See Stolt-Nielsen*, 130 S. Ct. at 1768-69. Here, the panel reached its procedural decisions by plausibly interpreting the CAR, which Lagstein's policy expressly incorporated.

C

In addition to the grounds relied upon by the district court for vacating the awards, Lloyd's argues that vacatur was warranted by arbitrator Whitehead's failure to disclose his and arbitrator Springer's roles in an ethics controversy that occurred in the early 1990s. Lloyd's argues that vacatur was required under § 10(a)(2) of the FAA, which applies "where there was evident partiality or corruption in the arbitrators, or either of them." 9 U.S.C. § 10(a)(2). We agree with the district court, however, that Lloyd's proved neither "an inappropriate relationship or contact between the judges, nor a failure to disclose information that would warrant vacating the award."[9]

To show "evident partiality" in an arbitrator, Lloyd's either must establish specific facts indicating actual bias toward or against a party or show that Whitehead failed to disclose to the parties information that creates "[a] reasonable impression of bias." *Woods* v. *Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996); *see also Commonwealth Coatings Corp.* v. *Cont'l Cas. Co.*, 393 U.S. 145 (1968). The evidence that Lloyd's offers falls short of this standard.

Under the FAA, vacatur of an arbitration award is not required simply because an arbitrator failed to disclose a matter of some interest to a party. Instead, Whitehead was required to disclose only facts indicating that he "might reasonably be thought biased

[9] We review de novo the district court's standard for impartiality. *Woods* v. *Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996). "Factual findings underlying the court's decision will be reversed only for clear error." *Id.*

against one litigant and favorable to another." *Commonwealth Coatings*, 393 U.S. at 150 (emphasis added); *see also Woods*, 78 F.3d at 427 ("[V]acatur is appropriate where the arbitrator's failure to disclose information gives the impression of bias *in favor of one party*." (emphasis added)).

Lloyd's has failed to show any connection between the parties to this arbitration and any of arbitrator Whitehead's past difficulties that would give rise to a reasonable impression of partiality toward Lagstein.[10] Whitehead's alleged misconduct occurred more than a decade before this arbitration and concerned neither of the parties to this case. *See PaineWebber Group, Inc.* v. *Zinsmeyer Trusts P'ship*, 187 F.3d 988, 995 (8th Cir. 1999) (characterizing a claim of evident partiality as "border[ing] on the frivolous" where there was no alleged relationship between the parties and the arbitrators, and "there [was] no evidence the arbitrators had any financial or personal interest in the outcome of the arbitration"). The district court was not required to accept Lloyd's argument that an allegation of past abuse of power necessarily demonstrated likely partiality against Lloyd's in the present case. Indeed, Whitehead disclosed that he had mediated "multiple cases for Lloyd's of London" in his mediation practice.

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[10] Considering the absence of any connection between this arbitration and the previous controversy, we also conclude that the district court did not clearly err in rejecting Lloyd's argument that, in light of arbitrator Springer's defense of arbitrator Whitehead in the prior controversy, Springer would be unable to remain sufficiently independent in this case to avoid evident corruption or partiality.

All three arbitrators in this case discharged their disclosure obligations by providing information concerning their relationships with the parties, their attorneys, and those attorneys' law firms. If Lloyd's desired additional information about the arbitrators' backgrounds, it was free to seek that information by its own efforts.[11] We decline to create a rule that encourages losing parties to challenge arbitration awards on the basis of pre-existing, publicly available background information on the arbitrators that has nothing to do with the parties to the arbitration. The district court did not clearly err in concluding that Lloyd's failed to show evident partiality.

For similar reasons, there is no merit to Lloyd's claim that the award must be vacated on the ground of "evident ... corruption." 9 U.S.C. § 10(a)(2). We have not previously been called upon to define "evident corruption," but Lloyd's evidence fails to satisfy any reasonable definition of that term. Its evidence of alleged corruption at some time in the past does not relate to this case or the parties to it, nor does it raise a "reasonable impression of corruption" in the present case.

Therefore, because Lloyd's failed to demonstrate either evident partiality or evident corruption in the arbitrators within the meaning of § 10(a)(2), the district court correctly rejected those possible grounds of vacatur.

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[11] We note that details of the Whitehead controversy were publicly available and easily could have been discovered if Lloyd's had conducted even minimal due diligence on the arbitrators' backgrounds.

CONCLUSION

We previously have observed that, "[p]ossibly because the nature of our review in these cases is so unusual, there may be a tendency for judges, often with the most unobjectionable intentions, to exceed the permissible scope of review and to reform awards in [the judge's] own image of the equities or the law." *Stead Motors of Walnut Creek* v. *Auto. Machinists Lodge No. 1173*, 886 F.2d 1200, 1204 (9th Cir. 1989) (en banc). Under the FAA, however, the reform of arbitration awards, including the severe remedy of vacatur, is limited by those grounds established by Congress in the Act. Because we conclude that vacatur in this case was not warranted by any of the grounds permitted by § 10 of the FAA, we reverse the district court's vacatur of the arbitration awards and remand for confirmation of all of the awards.

REVERSED and REMANDED with instructions.

APPENDIX B

UNITED STATES DISTRICT COURT
THE DISTRICT OF NEVADA

ZEV LAGSTEIN, M.D.,

Plaintiff,

vs.

CERTAIN UNDERWRITERS AT LLOYDS OF LONDON, a foreign insuring entity,

Defendants.

No. CV-S-03-1075-RCJ

ORDER ON DEFENDANTS' MOTION TO VACATE THE ARBITRATION AWARD, PLAINTIFF'S MOTION TO STRIKE, AND RELATED MOTIONS

Pending before the Court is Defendants' Motion to Vacate Arbitration Award (Dkt. 49), Defendants' Supplemental Brief in Support of Motion to Vacate Arbitration Awards of 9/1/06 and 12/15/06 (Dkt. 70), Defendants' Amended Motion to Vacate Memorandum (Dkt. 71), Plaintiff's Cross Motion to Vacate the Award (Dkt. 98), and Plaintiff's Motion to Strike Hazard and Gillers Declarations and Related Exhibits and Further Declaration of Counsel Anna M. Martin and Related Exhibits (Dkt. 83). The Court held a hearing on these motions on May 14, 2007, and made certain findings on the record, which are incorporated herein and discussed below.

BACKGROUND

Plaintiff filed this insurance bad faith action on September 5, 2003. (Dkt. 1.) Defendants subse-

quently moved to stay the action and compel Plaintiff to submit to binding arbitration pursuant to the underlying insurance policy at issue. (*See* Dkt. 22.) The matter proceeded to arbitration on July 11, 2006 through July 14, 2006 by an arbitration Panel comprised of Ralph O. Williams III, Esq., the Honorable Jerry C. Whitehead (retired), and the Honorable Charles E. Springer (retired).

On August 31, 2006 a Majority of the Panel (Arbitrators Whitehead and Springer) the ("Majority") issued a *Decision of Arbitration Panel and Award*, finding in favor of Lagstein on all claims and awarding (1) $900,000 in damages for breach of contract, bad faith, and repudiation of the insurance contract, (2) $1,500,000 in bad faith compensatory/emotional distress damages, (3) $350,000 in attorneys' fees, and (4) interest. (Dkt. 45.) The Majority further determined that punitive damages would be assessed against Defendants, and set a future hearing to consider the amount of the punitive award. (*Id.*) Arbitrator Williams filed a dissent. (Dkt. 46.)

On December 1, 2006, Defendants filed their Motion to Vacate Arbitration Award (Dkt. 49) and various declarations and exhibits in support of the award (including newspaper articles) and the declarations of Geoffrey C. Hazard, Jr. (Dkt. 50), and Stephen Gillers (Dkt. 51). Plaintiff moved to stay proceedings on the Motion until the arbitration proceeding had been completed. (Dkt. 60.) The Court granted the stay request, and ordered Defendants to file a supplemental brief within twenty days of the arbitration award. (Dkt. 62.)

On November 21-22, over Defendants' objection, the Panel held the hearing they previously ordered to decide the amount of the punitive damages award.

On December 15, 2006 the Majority issued the *Arbitrators' Majority Decision and Punitive Damages Award* and awarded punitive and exemplary damages against Defendants and in favor of Plaintiff in the amount of $4,000,000. (Dkt. 63.) Arbitrator Williams filed a *Dissent from Arbitrators' Majority Decision and Punitive Damages Award.* (Dkt. 69.)

LEGAL STANDARD

The Federal Arbitration Act ("FAA") authorizes district courts to enforce or vacate an arbitration award entered pursuant to a contractual arbitration agreement between parties. 9 U.S.C. §§ 9-11. Under the FAA, judicial review is limited and highly deferential. *See Sheet Metal Workers Int'l Ass'n No. 359* v. *Arizona Mechanical & Stainless, Inc.*, 863 F.2d 647, 653 (9th Cir. 1988). The FAA sets out specific grounds a Court may vacate an arbitration award, including:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them hat a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a). In addition to these statutory grounds, courts may vacate an arbitration award that is irrational or exhibits a "manifest disregard of the law." *Todd Shipyards Corp.* v. *Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1991).

DISCUSSION

I. Motion to Vacate

The total size of the award shocks the Court's conscience, is biased, and cannot stand. Despite the fact Dr. Lagstein began working again in December 2002, the panel majority nevertheless accelerated the sums due under the policy and granted $900,000 in benefits. The Panel also awarded $1,500,000 in emotional distress damages. The record does not support these figures, and they are in manifest disregard of the law. Furthermore, the Majority's award of punitive damages went beyond the jurisdiction of the arbitration, which expired on September 1, 2006, pursuant to the express agreement of the parties. The size of the punitive damages award is also excessive. Taken together, the size and scope of the awards shock the Court's conscience and contravene public policy. They must be overturned. The Panel exceeded its powers in entering these awards and retaining jurisdiction to enter untimely punitive damages awards. The Court rejects Defendants' remaining grounds for vacating the award, and finds that there has been no showing of an inappropriate relationship or contact between the judges, nor a failure to disclose information that would warrant vacating the award. For these reasons, and the reasons stated on the record, the Award is vacated.

II. Motions to Strike and Sanctions

For the reasons set forth on the record, the Declarations of Hazard and Gillers are stricken. Any other declaration/affidavit or support submitted by Defendants that relies on newspaper articles is stricken. The Court finds that Defendants' reliance on newspaper articles is improper and warrants sanctions. The Court will set the amount of sanctions in a separate order after reviewing the affidavit concerning attorneys' fees to be submitted by Plaintiff's counsel.

III. Other Filings

Defendants have also filed: (1) Motion for Leave to File Certified Copies of Exhibits and Request for Judicial Notice (Dkt. 115); and (2) Motion to Strike Reply to Response to Motion, or in the Alternative, for Leave to File Surreply (Dkt. 116). The Court denies these motions as moot.

CONCLUSION

Accordingly,

IT IS ORDERED the Motion to Strike (Dkt. 83) is **GRANTED IN PART AND DENIED IN PART**.

IT IS FURTHER ORDERED Defendants are assessed with sanctions in an amount to be set in a separate order.

IT IS FURTHER ORDERED the Amended Motion to Vacate (Dkt. 71) is **GRANTED**.

IT IS FURTHER ORDERED the Motion to Confirm (Dkt. 98) is **DENIED.**

IT IS FURTHER ORDERED the Motion for Leave to File Certified Copies of Exhibits and Request for Judicial Notice (Dkt. 115); and Motion to

Strike Reply to Response to Motion, or in the Alternative, for Leave to File Surreply (Dkt. 116) are **DENIED** as moot.

DATED: August 14, 2007

/s/
ROBERT C. JONES
UNITED STATES DISTRICT JUDGE

APPENDIX C

Excerpts of hearing on motion to dismiss containing district court's statement of reasons for granting motion.

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA
LAS VEGAS DIVISION

ZEV LAGSTEIN, M.D.,
Plaintiff,
vs.
CERTAIN UNDERWRITERS AT
LLOYDS OF LONDON,
Defendant.
CASE NO: 2:03-CV-1075-RCJ-LRL
CIVIL
Las Vegas, Nevada
Monday, May 14, 2007
(10:05 a.m. to 10:40 a.m)
MOTION TO VACATE (#49 & #71)

BEFORE THE HONORABLE ROBERT C. JONES,
UNITED STATES DISTRICT JUDGE
Appearances: (See next page)
Court Recorder: Araceli Catu
Proceedings recorded by electronic sound recording;
transcript produced by transcription service.

...

Page 3 - 6

THE COURT: Thank you.

Let me give you some predilections about the pleadings you've filed. You've raised rather an outrageous dispute and in an outrageous way.

First my impression is that this arbitration award cannot stand. It goes beyond bounds, especially in the punitive damages portion. At the same time I'm going to say the defense to it and the method to defending it is outrageous. The citation, especially relying only on hearsay as a foundation for attacking the biased state of the arbitrators, is outrageous, and I intend to impose sanctions. I'm noticing you of that, and we'll discuss that in a separate hearing.

And, of course, I consider also striking the affidavits of the experts and any affidavits that contain simply newspaper articles for foundation. That violates the ethics, as far as I'm concerned, of your professional ethics, and it goes beyond bounds.

Having said that, though, this judgment cannot stand. It is also an outrageous judgment. Thinking to myself over the weekend how this could have happened, I think I've reached a conclusion. And it was Defendant Kiln's attorney who, obviously, just so ticked off these arbitrators in maintaining a position of non-responsibility that this award was the result. That's the only thing I can ascribe it to. But as we hear commonly, you can be a pig, but you cannot be a hog. And that's what this award does, quite frankly.

I certainly understand fully a finding that the Kiln violated Nevada statutes and violated their common law requirements to disclose. They clearly violated according to the panel, and even according to the dissent, or may have violated according to the dissent, the obligation to give an answer by date cer-

tain. That they violated. And the declination comes years later as the panel cites.

What I do not understand is a finding of total repudiation of the policy and the awarding of a full $900,000 for three years. That I do not understand. I might understand that based upon this record and based upon a bad faith finding, which is legitimate, of $900,000 if that was it. This $900,000, and certainly in combination with the million and a half, is full recovery and it punishes and it compensates for emotional damage and distress as well as compensation for the policy. But not so limited in this arbitration award, I simply do not understand it, how repudiation and a full $900,000 award can be given in addition to the other elements being fully awarded.

It's clear that even if the panel is right, which I think they are, that the reason the doctor went back to work in -- February of 2002? Is that it? February of 2001 or 2002? February of 2002? Is that it?

...

The panel says he went back to work out of destitution, out of no other alternative, and the Kiln pushed him to that. I can accept that finding. And there is also admission that he worked partial hours, clearly far less than what he was doing pre-disability. But there is every admission that from December of that year forward he worked to the full extent that he did pre-disability. In fact, in one year -- I forgot what year -- $5 million and more of gross.

There is every place in this record to recognize that even if there was disability fully accrued and payable and even if there was reduced work and work caused by the Kiln in their own bad faith, nevertheless, after December of 2002 he's working full

tilt and there is nothing in destitution that causes a person to work full tilt, and it's clearly contradictory to any finding that he was disabled after December of 2002. That just doesn't stand.

Again, I could understand a full repudiation and a full 900,000 if that were it, if the saying was: That awards everything. But the panel doesn't do that. They go on to give a million and a half damages for emotional distress. That's a huge number, and from the award it appears like it comes out of nether land. It comes out of space. There is no explanation for the calculation of it. Every citation of the ground for giving an award -- and I agree with the citation -- but there is absolutely no basis for the calculation of the award. Even those two elements I could see stand. But it simply cannot stand with the $4 million punitive damages that is given in a subsequent hearing. That just doesn't make any sense at all.

... I am telling you this judgment will not stand. This Court will not confirm it. And, of course, you may have to seek the appellate court to affirm it.

...

Pages 27 - 31

THE COURT: It's the total that offends me, and it does shock the conscience, the total. What he's being compensated for is bad faith, failure to pay timely what he was entitled to, the monthly disability when it accrued, you know, 90 days after October 23rd. He's to be compensated for the emotional distress that that caused him. The fact that he went back to work and the fact that he potentially suffered further physical harm by going back to work; he is to be compensated for that.

...

THE COURT: So it seems to me that full — this is getting into the merits, of course, but I only cite it as the basis for why the total figure shocks my conscience. It seems to me that, as the dissent said, at the outside, he's entitled to the full 15,000 through December of '02. After that he's not only working part time, because of financial constraint, he's working full time. He's working $5 million gross for a year.

And it shocks my conscience to, therefore, contrary to the provisions of the policy, to give him 15,000 a month for periods for which he's not just working out of constraint from Kiln's activities, but, obviously, for his own motivation. And it shocks my conscience when it's combined with a total of a million and a half, which I don't challenge other than to say that there is no support in the record for that figure, and then, most importantly, when you combine it with $4 million of punitive. That shocks my conscience. That's not only overcompensation; it even violates the Supreme Court standards, as far as I'm concerned, with respect to punitive damages.

...

And so that you have it fully on the record, you may want to make all of your arguments to an appellate court, because, obviously, I think both sides are using the potentially inappropriate arguments that got this panel worked up in the first place. I don't ascribe it to any bias on the part of the judges; I ascribe it to the activities of the lawyers. And that's the way I explain it in my mind. But the award itself does shock my conscience.

You know the word "remittitur."

MR. HUDSON: I do.

THE COURT: And, of course, I'm putting it on the record rather than privately to the parties so that the appellate court can clearly second-guess my actions and can strike them and act on its own if it so chooses.

But have you considered, are you in a position yet at this point in time to consider remittitur, for example, of the whole award minus any punitive damage award?

MR. HUDSON: Am I in a position to consider whether to accept a remittitur or –

THE COURT: That's correct.

MR. HUDSON: No. No, your Honor.

THE COURT: Okay. I'll give you ten days to do that. And if you decline, I am going to decline to – and I am going to decline to confirm this arbitration award. It shocks the conscience, and it's wrong in several respects. It certainly goes beyond jurisdiction time with respect to the punitive damages.

At the same time my ruling will be that the affidavits of the experts are stricken. Any portion of any affidavit or support relying upon hearsay newspaper articles is stricken, and my ruling will be that there has been no sufficient showing of any inappropriate contact or relationship between the two judges on the arbitration panel, but that internally the bias is demonstrated by the amount of the award and the fact that the total award shocks the mind of the judge considering the issue.

...

MR. HUDSON: Well, in our view – and I don't know that Lloyds would disagree – that the Court's only power is under the FAA and not the –

THE COURT: That's right.

MR. HUDSON: – and the Court can modify the award, but I don't think in the method in a true remittitur sense.

THE COURT: I think you're right.

MR. HUDSON: So I think the Court can either vacate or confirm the award.

THE COURT: Okay. I'll vacate the award.

APPENDIX D

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
ZEV LAGSTEIN, M.D.,
Plaintiff - Appellant,
v.
CERTAIN UNDERWRITERS AT
LLOYD'S, LONDON,
Defendant - Appellee.
No. 07-16094
D.C. No. CV-03-01075 RCJ
O R D E R

Before: B. FLETCHER, CANBY, and GRABER, Circuit Judges.

Appellee's request for judicial notice is granted.

The panel has unanimously voted to deny the petition for panel rehearing. Judge Graber voted to deny the petition for rehearing en banc, and Judges Fletcher and Canby have so recommended.

The petition for en banc rehearing has been circulated to the full court, and no judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35(b).

The petition for panel rehearing and the petition for rehearing en banc are denied.

FILED JUL 27 2010
MOLLY C. DWYER, CLERK,
U.S. COURT OF APPEALS

APPENDIX E

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA
ZEV LAGSTEIN, M.D.,
Plaintiff,
vs.
LLOYD'S UNDERWRITER AT LONDON, a foreign insuring entity,
Defendants.
Case No.: CV-S-03-1075 LRH (LRL)

DECISION OF ARBITRATION PANEL AND AWARD

The subject of this arbitration is a civil action by Plaintiff Zev Lagstein ("Lagstein") against Kiln on behalf of those Certain Underwriters at Lloyd's, London, subscribing to Certificate Number 997401 ("Lloyd's"). Lagstein sues Lloyd's on a disability income insurance policy issued by Lloyd's on January 15, 1999. Lagstein asserts the following claims for relief: (1) that Lloyd's breached the insurance contract by failing to pay benefits due under the contract; (2) that Lloyd's breached the implied covenant of good faith and fair dealing; and, (3) that Lloyd's violated the Nevada Unfair Claims Practices Act, NRS 686A.310.

This matter was arbitrated on July 11, 2006 through July 14, 2006 by the arbitration Panel comprised of the Honorable Charles E. Springer, the Honorable Jerry C. Whitehead and Ralph O. Williams III, Esq. in Las Vegas, Nevada. Plaintiff Lagstein was represented by Charles J. Surrano, Esq. of

Surrano Law Offices. Defendant Lloyd's was represented by Joseph M. Rimac and Anna M. Martin of Rimac & Martin.

FINDINGS OF FACTS, CONCLUSIONS OF LAW AND DECISION

Having considered the evidence stipulated to and introduced by the parties at the Arbitration, the Panel makes the following findings of facts, conclusions of law, decision and award:

I.
BREACH OF CONTRACT

In his first claim for relief, Lagstein alleges that Lloyd's breached the disability insurance policy by failing to pay to him his disability benefits when he became disabled. An insurance policy is a contract which must be enforced according to its terms to accomplish the intent of the parties. *Farmers Ins. Exchange* v. *Neal*, 119 Nev. 62, 65. 64 P.3d 472 (2003). Lagstein had the initial burden of proof to demonstrate that he had suffered a covered loss, namely, his total disability. *Couch on Insurance* (3d) § 147:29; and, *Nat'l. Auto. & Cas. Ins. Co.* v. *Havas*, 75 Nev. 301, 303, 339 P.2d 767 (1959). *See also Lucini-Parish Ins., Inc.* v. *Buck*, 108 Nev. 617, 620, 836 P.2d 627, 628 (1992) (a party who seeks to recover on an insurance policy has the burden of establishing any condition precedent to coverage).

Once the insured makes a prima facie case that claim is within the terms of the policy, the burden shifts to the insurer to show any facts exempting it from liability. *Couch, infra* at pg. 147:48. Thus, where an insured demonstrates his eligibility for disability benefits, the burden of proof is on the insurer to show that the disability has ceased. *Id.*

The Panel holds that Lloyd's has breached its insurance contract with Lagstein. Lagstein has clearly demonstrated his eligibility for disability benefits; and Lloyd's has made no showing that Lagstein's disability ceased at any time from the date disability commenced through the date of this Decision and Award. Aside from any procedural considerations as to burden of proof, the Panel finds, by a preponderance of evidence, that, once established, Lagstein's disability status is uninterrupted and that he is entitled to recover the policy benefits of $15,000 per month as specified in the Award issued herein.

A. THE DISABILITY INSURANCE POLICY

On October 21, 1998, Lagstein applied in writing for a disability insurance policy with Petersen International Underwriters, Underwritten by Certain Underwriters at Lloyd's of London ("Lloyd's"), where he sought a monthly benefit of $15,000 if he became disabled.[1] In his application, Lagstein disclosed that his gross earnings for that year were approximately $1,000,000, that he had a disability policy with Paul Revere Insurance Company which would pay $18,0[illegible]er month if he became disabled and that he had a [illegible]art murmur.

During the underwriting of Lagstein's application, because of Lagstein's heart murmur, Lloyd's required that Lagstein be examined by a paramedic and then later by a physician. The physician had Lagstein undergo a stress test. Lloyd's determined that Lagstein constituted an acceptable risk. Conse-

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[1] Peterson was the broker and the American company that issued the policy on behalf of the insurers at Lloyd's, to Certain Underwriters, the syndicate.

quently, Lloyd's accepted the application and issued a disability insurance policy to Lagstein, effective January 15, 1999 with certificate number 997401. This was a binding insurance agreement.

Pursuant to this disability policy, Lagstein was obligated to pay semi annual premiums in the amount of $5,708.45. Lagstein paid these premiums throughout the duration of the policy. In exchange for the payment of the premiums, Lloyd's agreed to insure Lagstein in the event he became totally disabled as defined in the policy. Pursuant to the policy's Schedule of Benefits, Lloyd's agreed to pay to Lagstein monthly benefits in the amount of $15,000 plus the cost of living adjustments for 60 months if he became disabled. Lloyd's *did not* place any rider, exclusion or limitation concerning Lagstein's heart murmur. The policy provided that payments would commence following a 90-day elimination period.

B. LAGSTEIN PROPERLY SUBMITTED HIS CLAIM FOR TOTAL DISABILITY BENEFITS

1. International Risk Management Group

Lloyd's hired International Risk Management Group ("IRMG") to adjust this claim on its behalf. Mary Ann Gleason ("Gleason") was the main individual from IRMG who handled this claim. She was a registered nurse and a lawyer. She was also the President of IRMG, and owned one-third of the company.

Lloyd's was IRMG's main client. Lloyd's authorized Gleason to make all claims decisions on behalf of Lloyd's. Consequently, she did not report to Lloyd's;

rather, her communications with Lloyd's were "[m]ore as a courtesy."[2]

While many of the events of this claim took place between Lloyd's' independent adjustor, IRMG, and Lagstein, all actions or omissions were done on behalf of Lloyd's and with its full authority. For purposes of simplicity, therefore, when this decision refers to Lloyd's, such a reference does not seek to distinguish Lloyd's from IRMG unless expressly stated otherwise.

2. The Submission of the Claim

On December 4, 2001, Lagstein submitted, and Lloyd's received, a properly executed proof of loss statement, stating that he was totally disabled and had been since October 23, 2001.[3] In compliance with

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[2] Notably, in her deposition testimony which was presented at the Arbitration, Gleason asserted an attorney-client privilege as to certain communications which she had with Lloyd's, contending that not only was she acting as the adjuster but, at times, she was legal counsel, providing legal advise at the same time that she was adjusting this claim. Furthermore, IRMG hired Lloyd's' defense counsel and when questions were posed as to whether Gleason obtained a coverage opinion, they asserted the attorney-client privilege.

According to Gleason, her company did not report to Peterson, the broker, other than to advise it that the file's been opened and had been assigned a claim number.

[3] The two-page proof of loss form was titled: "INSURED'S STATEMENT" and had a subheading of "DETAILS OUTLINING PROOF OF LOSS FOR DISABILITY INSURANCE," This form was on the letterhead of both Petersen International Underwriters and IRMG. Notably, Lagstein initially asserted two different disability claims: (a) one for an automobile accident, causing a disability from cervical radiculopathy; and (b) one for illnesses, including, but not limited to aortic stenosis, migraine headaches, and chronic fatigue syndrome,

Lloyd's' proof of loss form, Lagstein identified eight of his treating physicians. Lagstein also identified that he had another individual disability policy through Paul Revere Insurance Company ("Paul Revere"). Lagstein provided Lloyd's with a written Authorization To Obtain Information so that Lloyd's could independently obtain all of his medical records, speak with his treating physicians and obtain all information from his other disability carrier, Paul Revere.

NAC 686A.670 requires an insurer to mail or otherwise provide each claimant "a notice of all items, statements and forms, if any, which the insurer reasonably believes will be required of the claim-ant, within 20 working days after receiving notice of the claim." Lloyd's, therefore, had until January 2, 2001 to provide Lagstein with this notice of necessary information. On December 10, 2001, Lloyd's wrote to Lagstein, stating that it needed several items, including: (1) attending physician statements;[4] (2) tax returns from 1997 through 2000; and, (3) Lagstein's pay stubs.

Lagstein timely responded to Lloyd's' request for information. On December 14, 2001, Lagstein forwarded copies of his tax returns and his profit and

However, Lagstein withdrew his disability claim for the injuries which he suffered in his automobile accident and the only matter tried to the panel was his claim for disability arising out of his illnesses.

[4] When Lloyd's forwarded to Lagstein the Attending Physician's Statement forms, it attached a copy of the Medical Profession Endorsement, which defined Total Disability as: "TOTAL DISABILITY MEANS THAT DUE TO SICKNESS AND/OR INJURY YOU CANNOT PERFORM THE SUBSTANTIAL AND MATERIAL DUTIES OF YOUR OCCUPATION AND THAT YOU ARE NOT ABLE TO PERFORM IN ANY PROFESSIONAL CAPACITY WITHIN THE MEDICAL PROFESSION."

loss statements (in lieu of pay stubs because he was self employed and did not receive pay stubs). Lagstein also informed Lloyd's that his attending physician statements were forthcoming.

On December 21, 2001, Lagstein provided Attending Physician Statements from two of his treating physicians, Dr. Benjamin Cohen and Dr. Charles Bernick. These physicians determined Lagstein was permanently totally disabled as of October 23, 2001. Indeed, on the form provided by Lloyd's, the physicians certified "that the above-named patient is disabled from engaging in the duties of their respective occupation."

Dr. Cohen, a cardiologist, certified that Lagstein was disabled from "aortic stenosis sp Ross procedure" and a post-operative ventricular fibrillation. Dr. Cohen explained that Lagstein suffered from recurrent post-operative sudden death secondary to ventricular fibrillation and hypertension. Dr. Cohen certified that Lagstein was totally disabled from the practice of medicine.

Dr. Bernick, a neurologist, diagnosed that Dr. Lagstein was suffering from "complicated migraine, chronic fatigue syndrome and valvular deumi." Dr. Bernick also certified that Lagstein could not return to the practice of medicine.[5]

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[5] After providing the Attending Physician Statements, Lagstein's counsel forwarded copies of medical records From Drs. Cohen and Bernick, which further supported their Attending Physician Statements. Indeed, in Dr. Bernick's October 3, 2001 notes, he concludes that Lagstein's migraine's attacks arc severe enough to impair his function and make him unable to continue his work in cardiology. Dr. Cohen's records reflect that Lagstein would be consulting with Dr. Wiener. In Dr. Wiener's

3. Lagstein's Proof of Loss Demonstrated That He Was Permanently Totally Disabled

Lagstein demonstrated that he was permanently totally disabled. The disability policy effective January 15, 1999 defined "total disability" as "due to sickness or injury you cannot perform the substantial and material duties of your occupation." The insured was listed on the application as a cardiologist with the majority of his income being as an invasive cardiologist. By way of a medical profession endorsement, dated January 20, 1999, Lloyd's said the definition of total disability is re-defined to read: "Total disability means that .... you cannot perform the substantial and material duties of your occupation and that you are not able to perform in any professional capacity within the medical profession." Lloyd's then stated that the effective date of the endorsement related back to the inception of the policy, that is, January 15, 1999.[6]

Both Dr. Cohen and Dr. Bernick certified that, as of October 23, 2001, Lagstein was permanently totally disabled as a medical doctor.

The disability policy contained a 90 day elimination period, which was defined as follows: "the number of consecutive days you are totally disabled before a benefit is payable. The elimination period begins on the first day you become totally disabled: Therefore, Lagstein's elimination period ended on

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December 21, 2001 medical record, Dr. Wiener states that Lagstein "should be considered permanently disabled."

[6] The Parties both used the definition of disability set forth in the endorsement and, therefore, the Panel has used that definition in deciding this case.

January 22, 2002. Lagstein met the elimination period: indeed, as of January 22, 2002, there was no evidence which Lloyd's could have reasonably relied upon to dispute or question that Lagstein was disabled during the period of October 23, 2001 through January 22, 2002.

4. Lagstein's Medical Conditions

Even if Lloyd's had some reasonable basis to continue its investigation into Lagstein's medical condition, which it did not, any reasonable, fair investigation would have confirmed Lagstein's total disability. In approximately August of 2001, Lagstein began experiencing chest pains, palpitations, dizzy spells, and shortness of breath. His normal activities became difficult to perform, such as walking his rounds or walking a flight of stairs. As a result, after oral consultation with Dr. Laks a cardiologist at UCLA, Lagstein was seen by Dr. Benjamin Cohen, another cardiologist from UCLA. Dr. Cohen determined that Lagstein suffered from: a heavily calcified aortic valve with decreased cusp mobility; moderate ascending aortic dilation without aortic regurgitation; significant aortic stenosis (a narrowing of a main valve); and mild atherosclerotic plaque formation.

The aortic valve is the main valve which allows the left ventricle to eject blood into the aorta, from which the blood flows to all of the organs of the body. If the valve is narrowed, the amount of blood ejected from the heart is limited, which starves the body for blood and oxygen. Complications from this condition include irregular ventricular heartbeat, which can result in sudden death.

Dr. Cohen recommended a complicated open heart surgery to remove the severely diseased aortic

valve. On November 6, 2001, Dr. Cohen described in detail the complications which would exist after the surgery, and further recommended that:

> I advise Dr. Lagstein to retire from the practice of medicine. He should be considered totally and permanent disabled beginning 08/31/2001 (the date of the heart catheterization which confirmed the severity of the aortic stenosis and at which point it was discovered that he was more symptomatic than first it appeared).

While Dr. Cohen had advised Lagstein to stop working in August of 2001, Lagstein could not immediately shut down his practice. Instead, he significantly reduced his hours as he got his affairs in order and prepared to have the surgery.

On October 3, 2001, Lagstein saw Dr. Bernick, a neurologist, for his migraines and chronic fatigue syndrome. Dr. Bernick found that the severity of the migraines were such that it would impair Lagstein's ability to continue with his work. In fact, it was affecting Lagstein's memory and judgment. By this time, Lagstein was only working on a very limited basis.

In the middle of October 2001, Lagstein experienced another cardiac incident related to his aortic stenosis. This event was so frightening to Lagstein that he ceased working on October 23, 2001.

On November 21, 2001, Lagstein underwent an open heart surgery, known as a Ross procedure, to treat his aortic stenosis. The surgery was performed by Dr. Oswalt in Austin, Texas. It was a complicated procedure, resulting in eight days of hospitalization. The surgeon removed Lagstein's aortic valve, re-

placed it with the pulmonary valve, and then installed a prosthetic pulmonary valve. In addition, the surgeons had to repair his ascending aorta. However, postoperatively, Lagstein suffered three different cardiac arrests (ventricular fibrillation), which required CPR and defibrillation to save Lagstein's life.

When Lagstein returned to Las Vegas, he was followed up by Dr. Weiner, an electrophysiologist at UCLA. An electrophysiologist is a cardiologist who specializes in heart rhythm abnormalities. Not surprisingly, on December 20, 2001, Dr. Weiner concluded that Lagstein was permanently disabled and advised him that he should not return to work. Dr. Weiner eventually recommended that Lagstein undergo another procedure, where a defibrillator was installed into Lagstein's heart to avoid sudden death. Each of these events placed Lagstein at greater risk for sudden death.

In early January, 2002, an x-ray revealed Lagstein had early signs of congestive heart failure, a condition where his heart was not properly pumping the blood, causing fluid to accumulate in the lungs and causing shortness of breath.

On January 31, 2002, Lagstein underwent the surgery recommended by Dr. Wiener. It took place in Long Beach, California.[7] As noted above, this surgery involved the placement of an internal cardiac defibrillator (a pacemaker). He was hospitalized for two days.

In early 2002, after his surgery, he saw Dr. Randy Lieberman, the head of electrophysiology at

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[7] Lagstein called several days before this operation to let Lloyd's know he was undergoing the second surgery.

Wayne University in Michigan. Dr. Lieberman recommended that Lagstein should not engage in "any stressful activities including work."[8]

On February 7, 2002, Dr. Jaswinder S. Grover saw Lagstein. Dr. Grover noted that Lagstein suffered from a multitude of disorders, including chronic fatigue syndrome, hypertension, chronic migraines, and post implantation of the defibrillator which had resulted in significant discomfort in his left chest muscle, with marked restriction of his left shoulder and signs of frozen shoulder syndrome. Dr. Grover noted that Lagstein was also on multiple medications. Dr. Grover believed that Lagstein was totally disabled at the time.[9]

In the spring of 2002, Lagstein was admitted to the hospital and had several visits to the emergency rooms because of episodes and complications with his heart conditions. During this time, he was discharged on blood thinners and was taking a multitude of medications.

In 2003, Lagstein's defibrillator discharged in rapid succession, which almost rendered him unconscious. Prior to the discharges, it shocked him, the force of which knocked him to his knees. In June of 2003, he had to have the defibrillator removed and have a new, improved device installed.

In December of 2005, Lagstein underwent coronary angiography, which showed that his heart was enlarged and that he had blockage of one artery. At

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[8] On April 22, 2002, Lagstein's counsel faxed Dr. Lieberman's records to Lloyd's.

[9] On February 20, 2002, Lagstein's counsel faxed Dr. Grover's records to Lloyd's.

the time of the arbitration hearing, Lagstein was taking fourteen different medications.

The Panel finds that there should have been no question to Lloyd's that Lagstein was totally permanently disabled from the medical profession. Moreover, the overwhelming evidence presented at the arbitration, including, but not limited to, the medical records stipulated to by the parties, Lagstein's testimony, Dr. Gott's initial IME report, and Dr. Bernick's testimony confirmed what his treating physicians had certified in December of 2001, namely, that he was permanently totally disabled.

C. LLOYD'S FAILED TO ACCEPT OR DENY THE CLAIM WITHIN THE TIME FRAME REQUIRED

According to Nevada's requirements, Lloyd's had 30 working days after receipt of Lagstein's properly executed proof of loss to advise Lagstein of the acceptance or denial of his claim. *See* NRS 689A.410 and NAC 686A.675(1). Lloyd's, therefore, had until January 17, 2002 to advise Lagstein of its acceptance or denial of his claim. Lloyd's failed to inform Lagstein whether it was accepting or denying his claim by January 17, 2002, even though Lloyd's had all of the information reasonably necessary to determine whether the claim should be accepted or denied. In violation of Nevada law, Lloyd's waited until July 29, 2005 – nearly three years and seven months after its deadline (1,332 days after the claim was submitted) to deny the claim.

In addition, Lloyd's failed to advise Lagstein in writing by January 12, 2002 that it needed more time to determine whether his claim should be accepted or denied and the reasons why more time was

needed. Notably, on January 10, 2002, Lagstein's attorney wrote Lloyd's, stating, "[i]f additional documentation is needed please advise at once." (Emphasis added.) Lloyd's failed to timely respond to this inquiry.[10]

Because Lloyd's failed to provide notice to Lagstein by January 12, 2002 that it was accepting or denying his claim or, alternatively, advising him that it needed an additional 30 days to investigate the claim because of a reasonable basis, Lloyd's breached NRS 689A.410, NRS 686A.310(1) and NAC 686A.675.

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[10] In fact, Lloyd's' next written communication to Lagstein's attorney was on February 5, 2002, nearly 19 days past the due date for Lloyd's to accept or deny the claim. Nowhere within that letter is there a direct response to Lagstein's counsel's inquiry. Instead, Lloyd's sought information concerning the physician who first diagnosed Lagstein's heart murmur – the condition which Lagstein disclosed in his application for insurance and which Lloyd's accepted without any riders or exclusion. There was no valid basis for this inquiry. Lloyd's further sought additional information about any other insurers for disability benefits, Lagstein identified these policies in his proof of loss and provided Lloyd's with a full release to obtain any information which it needed from Paul Revere. Moreover, when Lagstein's counsel forwarded additional medical records on January 10, 2002, it included an Attending Physician's Statement by Dr. Grover for his disability claim to Paul Revere. Therefore, if Lloyd's believed it was reasonably necessary to delay accepting or denying the claim in good faith, Lloyd's should have attempted to obtain this information directly from Paul Revere, especially where Lloyd's had required that Lagstein provide it with written authority as part of his initial proof of loss to obtain this very information.

D. LLOYD'S BREACHED THE DISABILITY INSURANCE CONTRACT BY FAILING TO PAY THE BENEFITS WHICH WERE DUE AND PAYABLE

The subject disability policy provided in clear and unambiguous terms that the payment of benefits *must* be made once a treating physician had "determined," as was the case here, that Lagstein was "permanently totally disabled." The following is the highly critical language of the policy:

> *Benefits will be paid if it is determined by the physician providing your regular care that you are permanently totally disabled.* (Emphasis added).

Drs. Cohen and Bernick certified that Lagstein was permanently totally disabled. Following the ninety day elimination period of January 22, 2002, however, Lloyd's failed to pay the benefits which were due and payable. Lloyd's had no basis to delay accepting this claim and commence paying the monthly benefits as they came due after the elimination period expired.

Therefore, Lloyd's breached the disability insurance agreement it had with Lagstein.

E. LLOYD'S' CONTENTION THAT LAGSTEIN 'WENT BACK TO WORK ON FEBRUARY 8, 2002 DOES NOT AFFECT OR "END" HIS ONGOING DISABILITY STATUS

Nothing in this case is clearer to the Panel than that, in accordance with the terms of the policy, Lagstein presented to Lloyd's sufficient medical evidence of disability and maintained that status for the re-

quired 90-day elimination period. The February 8 date that Lloyd's relies on throughout comes after Lagstein's permanent disability was firmly established. Consequently, February 8, 2002 is completely irrelevant when it comes to Lagstein's clear compliance with the elimination period condition of the policy. The Panel sees Lagstein's elimination period argument as being so baseless and unsupportable as to amount to mere pretense.

Lloyd's also contends (a bit inconsistently, given its insistence that Lagstein was *never* eligible for disability benefits) that Lagstein's going "back to work" on February 8 was the "end" of any purported disability on Lagstein's part. Again, it is quite clear from the evidence that Lagstein's disability status, medically established in December 2001 and January 2002 had not quickly "ended" at Lloyd's February 8, 2002 date. As discussed at length in this Decision and Award, Lagstein's being forced by Lloyd's denial of benefits to engage in a few, limited professional activities on February 8, 2002, cannot possibly be said to have brought an end to Lagstein's established disability status, on that date.

Lloyd's does not (other than February 8, 2002) offer another date upon which it claims that Lagstein's disability status ended. The Panel has examined the record and concludes that not only has Lloyd's failed to present proof that at any given time Lagstein's disability status was lost, the record does not support any finding by the Panel that disability status was lost.

Although Lloyd's did not argue the issue, it could possible be maintained that Lagstein's established disability was inconsistent with the reports furnished by Lloyd's independent medical examiners of

Lagstein, or inconsistent with Lagstein's income and professional workload during the years 2003 and 2004. It is not necessary, however, for the Panel to delve into these questions. Because of Lloyd's violation of the Unfair Trade Practices Act; because of Lloyd's knowing and wrongful refusal to commence benefit payments when they became due; and because of Lloyd's attempts to rewrite the policy, the Panel finds that Lloyd's *repudiated* its entire obligation under the policy. The Panel finds that this repudiation was effective no later than December 17, 2002.[11] This being the case the Panel need not consider the subject of lost disability status after December 17, 2002. The Panel finds that, because of Lloyd's repudiation, the contract is accelerated and the full amount of the policy obligation, $900,000, was due and payable on that date.

Were the Panel to consider the possibility of any loss of disability status after December 17, 2002, it would be compelled to conclude that disability status remained in effect after December 17, 2002 and up to and until the date of this Decision and Award. The Panel would, if it were considering the same, view such contentions in the manner following

With respect to the independent medical examinations, the Panel can find no date or time at which it should find that Lagstein lost his disability status. As noted below, the reports do not conclude that. If Lloyd's had actually come to the conclusion that these medical opinions were evidence that the disability had ended, Lloyd's ordinarily (were there no

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[11] By December 17, 2002 they had evidenced a clear intent to violate the referee provision of the policy and attempt to rewrite the policy.

scheme of intentional delay) would have promptly denied the claim. In contrast, Lloyd's continued to prolong the pending claim, never telling Lagstein, what appears to be the case, that his situation was hopeless and that payment was never to be forthcoming.

The IMEs failed to prove that Lagstein was not disabled from the medical profession. Dr. Chanderraj was a cardiologist, and while he found Lagstein's cardiac conditions did not keep Lagstein from working, the Panel finds contrary testimony more compelling. However, Dr. Gott, the neurosurgeon hired by Lloyd's concluded in his September 24, 2002 report that Lagstein was disabled. His initial independent opinion was so adamant that he wrote to Lloyd's, emphasizing, "Would you want this man working on your heart, or making decisions and providing your medical care."

Dr. Bernick, Lagstein's treating neurologist, testified at the Arbitration hearing as well as in reports that Lagstein was permanently disabled:

Q. Just so we're clear – I don't think there's any mistake, but it was your opinion that Dr. Lagstein was disabled from practicing medicine, right?

A. Correct

Q. Not just invasive cardiology?

A. Correct.

Q. Where he shouldn't be a doctor, right?

A. That's correct.

Dr. Bernick explained that one of the reasons for his disability from the practice of medicine was that

in his compromised medical state, he presented a risk to his patients.

> Q. Well, let me ask this question then: One of the reasons – would one of the reasons you would be telling Dr. Lagstein not to be practicing medicine be because of his compromised health, he might present a risk to the life of his patients?
>
> A. That's exactly the case. That is – my feeling in medicine is that, you know, if there's – if you have conditions that affect your ability to make decisions, to accurately assess situations, to treat people, particularly in more urgent situations, then that's a risk to patient care.

Dr. Bernick further testified that he became aware that Lagstein was working in 2002 and in his opinion, he should not have been working. While one IME opinion is in conflict with the plaintiff's cardiologist, the IME opinions together are unconvincing.

With respect to the money earned and work performed during 2003-2004 by Lagstein, there is no direct correlation between income and disability. Even if Lloyd's had advanced this position at the hearing, which it did not, the Panel could not put an end to Lloyd's obligation to pay benefits solely because of any income earned by Dr. Lagstein.[12]

It is apparent that after Lagstein was forced back to his office in the manner described, his work-

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[12] The information about the doctor's increased income in the years 2003-2004 was contained in the Paul Revere Insurance file. The Panel would note that after reviewing this income information, Paul Revere concluded that Lagstein was disabled.

load increased during the years 2003-2004. This, however, begs the important questions:

1) Was it against his doctor's advice?

2) Was it harmful to Lagstein? And

3) Was it against the best interests of the patients?

The Panel answers yes to each of these questions; and, because any earned income or supposed "return to work" were brought about by Lloyd's wrongdoing, would conclude that Lagstein's disability continued to the date of the hearing.

Disability insurance is designed to protect against the risk of loss of income caused by an injury or illness which either limits or destroys the insured's ability to work. Couch on Insurance (3rd Edition), § 147:9 at 147-20. Where, therefore, an insured is not disabled from work, he is not entitled to benefits. *Id.* "However, this does not mean that an insured who performs any work despite his or her condition is necessarily precluded from benefits." *Id.* Instead, recovery requires that the insured be unable to perform his essential job duties. *Id.* As noted by *Couch*:

> [T]he test is not whether the insured actually refrained from such work, *but rather whether one of ordinary prudence who steered from the insured's injuries would desist from his or her business or occupation in order to effectuate a cure.* Consequently, the fact that the insured has continued to work does not preclude a finding of total disability if common care and prudence dictated that he or she should not have done so, although it is a fac-

> tor to be considered by the trier of fact in determining whether the insured is totally disabled.

Couch, § 147:9 at 147:21 (emphasis added). See also *Colonial Life Accident & Life Ins. Co.* v. *Whitley*, 664 S.W.2d 488 (1984) (lack of disability is not established by the mere fact that one continues to work at his regular job; it is only a factor to be considered.)

An insured's return to work is not dispositive of his disability status where economic necessity compels the insured to return to work. *Lasser* v. *Reliance Standard Life Ins. Co.*, 344 F.3d 381, 392 (3rd Cir. 2003.) Similarly, the fact that the insured performs certain post-disability work does not prevent a finding of total disability, where the insured returns to work against the advice of his doctors. *Gross* v. *Unumprovident Life Insurance Co.*, 319 F.Supp.2d 1129 (C.D. Cal. 2004). In *Gross*, the Court explained:

> Plaintiff's performance of certain duties does not prevent a finding of total disability where Plaintiff performed those duties against his doctors' advice. "The ultimate fact to be determined is not what the plaintiff actually did in the way of business duties but what, in the exercise of common care and prudence, he was reasonably able to do. Proof of what he did is merely evidence tending to show his ability to do ... " "The fact that the insured may do some business duties during the time for which he claims indemnity for total disability or even the fact that he may be physically able to do so is not conclusive evidence that his disability is not total, if reasonable care and prudence requires that he desist."

Id. at 1157-58. *See also Maroney* v. *Prudential Ins. Co. of America*, 9 S.E.2d 872, 875 (W.Va. 1940) (where total disability is established for heart condition, the mere fact that the insured continues to work against the advice of his doctors and at the risk to his health and life, does not prevent a finding that he is entitled to his disability benefits); *Johnson* v. *State Farm Mut. Auto. Ins. Co.*, 342 So.2d 664 (La. 1977).

In this case, on February 8, 2002, Lagstein resumed some professional activities but *on a very limited basis* and against the advice of his doctors. Lagstein had purchased the disability insurance so that he could pay his financial obligations if he became disabled. When Lagstein became disabled, he had significant financial obligations, including his office expenses, salaries for his employees, overhead, maintenance of his home, and expenses related to his children's college education. Lagstein could not afford to pay these expenses if Lloyd's failed to pay his disability benefits. Notwithstanding the fact that Lagstein had established his disability and his entitlement to his benefits, Lloyd's failed to notify him of its acceptance of his claim within the time required by Nevada law.

A time came, after promised disability payments were not forthcoming from Lloyd's, when Lagstein began to fear that Lloyd's did not intend to pay his claim. Lagstein's fears were well founded. As a result, Lagstein felt he had no choice but to try to do some kind of work in order to generate income:

> So the sole income I had was, or would have had, would be from working. Without it I would have had no income, and my expenses were very high. And I felt that if I don't work,

> I will lose everything I had. I will have to sell my house, liquidate things that I may have, you know, all the things I worked for 30 years. And that's why I bought insurance from Paul Revere and Lloyd's to protect myself in case this happens to me. But the protection wasn't there when I needed it.

Lagstein's "going back to work," as Lloyd's puts it, was for the purpose of keeping the doors of his practice open long enough to sell it and to meet his expenses. He did not intend to, nor did he, resume a full time schedule nor did he initially work any longer than he believed was required to maintain a "going business" necessary in order to sell his practice. Lagstein began negotiating with four different doctors to sell his practice. He reasonably believed that if he did not maintain a patient base, he would not have had a practice to sell. Unfortunately, he was unable to sell the practice.

Lagstein's so-called return to work was against the advice of his doctors: and in doing what he did, he was placing himself at great risk of another cardiac incident. When his doctors learned he had returned to his office, even part time, they continued to advise him to cease working. As a result of his decision to try to keep his practice open, Lagstein suffered several medical complications. One of these complications resulted in his being hospitalized.

The Panel finds that if Lloyd's had paid Lagstein his disability benefits, he would not have had been subjected to the financial pressures which caused him to resume these activities. The Panel, accordingly, finds that Lagstein was still totally permanently disabled when he resumed some part-time activities on February 8, 2002. The Panel further finds

that Lagstein remained totally permanently disabled from the onset of his disability on October 23, 2001 through the date of issue of this Decision and Award, despite his so-called "return to work." Lagstein was forced to do something. This state of affairs is not uncommon in insurance practice. It is called by the disability insurance industry, "working disabled."

Where an insured demonstrates his eligibility for disability benefits, the burden of proof is on the insurer to show that the disability has ceased. *Couch, infra* at pg. 147:48. The evidence does not support a finding that there was in fact an "end date" to Lagstein's established permanent total disability. As we have held the mere fact of working or of making a significant amount of money, if (1) it is against medical advice; (2) of harm to the insured's health, and (3) jeopardizes his patients does not prove that the Doctor is not disabled. The Panel finds all three elements to be present in this case.

Lloyd's hired a field investigator, David Morse and Associates (DM&A), to go to Lagstein's office unannounced to conduct surveillance and further investigate the extent of his "return to work." In a report dated May 2, 2002, DM&A informed Lloyd's that:

> The insured states he was forced to return to work since no disability benefits were paid to him and he discussed his financial hardships as a result. He claims he now works part-time, 4 hours daily, against his treating doctor's advice. He further stated he no longer does hospital procedures and has resorted to taking SSI patients, which does not require

him to perform surgical procedures, only records review. [13]

If Lloyd's truly believed that Lagstein's return to this type of work justified a finding that he was not totally disabled, Lloyd's clearly had an obligation to deny his claim in a timely manner, which is to say, within 30 days of learning of this information. *See* NAC 686A.675. Lloyd's, in contrast, waited more than three years to deny the claim, stating in its July 29, 2005 denial letter that "[Lagstein] returned to work on 8 February 2002 and w[as] thus *no longer* totally disabled as that date." (Emphasis supplied.) There can be no reasonable, good faith basis for an insurer to wait this long to deny a claim on a ground which the insurer knew about three years and two months earlier.

The more one looks at the manner in which this claim was handled, the more a sinister pattern emerges. It appears that the management of Lloyd's claims followed this approach:

1. Insurance Company receives proper, medically-authenticated claim form that establishes disability eligibility after expiration of a 90-day "elimination period;"

2. Company immediately cancels the insured;

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[13] On April 17, 2002, Melcer from IRMC called Lagstein's office and falsely claimed to be a family member of one of Lagstein's patients. Lagstein's office apparently informed her that Lagstein was seeing patients that week.

3. Elimination period expires and first installment on the payment of a sizable sum of money becomes due and payable;

4. Company is aware of various, rather strict time limitations, set by statute, government regulation and industry standards, on time required for accepting or rejecting disability insurance claims; but, nonetheless, Company chooses to ignore or intentionally violate statutes, regulations and standards, and to undertake a plan for an extended delay in deciding to deny or accept a claim, intending to use that delay as a vehicle for escaping the obligations created by the insurance policy.

5. Rather than pay the first installment, which is clearly owing and known to the company to be clearly owing, Company decides not to pay in accordance with the policy and, instead, sets up a stalling scheme, the principal object of which is to try to find some defect in the initial contract of the parties or to establish grounds for future denial of benefits on the ground that the insured "returned to work."

6. In carrying out the described scheme, Company employs the following devices:

(a) delay engendered by the Company's engaging in a time-consuming post-claim investigation of a heart murmur that had been disclosed in the Lagstein insurance application (an impermissible practice of waiting until a large claim is filed to review an application in search of an excuse to cancel the policy - called "post-claim underwriting);

(b) delay engendered by the company's making a large number of false excuses for non-payment based on the pretense that Lagstein was not cooperating with the Company by failing to provide certain in-

formation" and documents that were either irrelevant or with Company's possession or readily accessible to Company;

(c) delay engendered by the hiring of an investigation firm hired for the apparent purpose of "catching" the insured at having "returned to work;"

(d) delay engendered by Company's demanding that the insured submit to a series of arguably unnecessary independent medical examinations.

There is no question here about Lloyd's' being well aware of applicable statutes, regulations and industry standards. Can there be any question that Lloyd's knew that it had to take action on the claim described above no later than early 2002? If Lloyd's knew of its legal and moral obligation to deny or accept the claim over three and one-half years before the decision was actually made, it is easy to divine just what could have induced Lloyd's to put off its decision for this extraordinarily long period of time. The answer to the question is that Lloyd's purposefully delayed its claims decision in order to carry out the scheme described above. Consequently, the Panel finds that the delay was brought about in the manner and for the motives described above and finds particularly that Lloyd's intentionally delayed making its claims decision for the express purpose of avoiding lawful payment of the Lagstein claim. This finding relates to and supports the tort damages award discussed in the following sections.

II
BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING: BREACH OF NEVADA'S UNFAIR CLAIMS PRACTICES ACT

Lagstein has also asserted claims for breach of the implied covenant of good faith and fair dealing and for violations of Nevada's Unfair Claims Practices Act, NRS § 686A.310 and NAC Chapter 686A.600. The Panel finds that the evidence overwhelmingly demonstrated that Lloyd's breached the implied covenant of good faith and fair dealing when it unreasonably denied Lagstein's claim, took over three years and seven months to deny it, engaged in acts of dishonesty and delay tactics and *repeatedly* acted unreasonably and with knowledge that it had no reasonable basis for its conduct. Furthermore, Lloyd's engaged in numerous acts which violated the Unfair Claims Practices Act, NRS 686A.310(a) – (e), and (m) – (n), and related Nevada Administrative Code. The Panel incorporates and re-states the finding contained in I-E above, relating to Lloyd's scheme for denying liability by use of a scheme of deception and delay, all which strongly supports the Panel's holding of fraud, oppression and malice, express and implied.

In discussing bad faith liability, the Panel finds that Lloyd's was in violation of Nevada's laws and administrative regulations, accepted industry practices, common decency and common sense to have delayed action on this claim for three and one-half years. It has been argued that Lloyd's claims handling was marked by an eerie degree of bumbling, incompetence and indifference, and that fortuitously, they just, with no real reason, "sat on" the claim.

Quite obviously, all of the requests for "information," tax returns, medical information and such, were irrelevant or unnecessary to the claims decision or were readily available to Lloyd's. It became obvious to the Panel that all of the excuses for non-payment, all the requests for more information, were mere pretense.

It took three and one-half years for Lloyd's to think that it was on safe grounds to deny the claim. Until that time they tortured Lagstein in the kind of malicious, oppressive and overpowering "cat-and-mouse" game discussed in the damage section of the Decision and Award. It is this type of conduct and the Panel's findings above which demonstrated an intentional scheme on Lloyd's' part to wrongfully deny the claim and, thus, repudiate the contract.

It is in this context that discussion continues.

A. STANDARD

1. The Implied Covenant of Good Faith and Fair Dealing

Nevada has long recognized the special relationship between the insurer and its insured. *Ainsworth* v. *Combined Ins. Co.*, 104 Nev. 587, 592, 763 P.2d 673, 676 (1988). "The relationship of an insured to an insurer is one of special confidence. A consumer buys insurance for security, protection, and peace of mind." *Id.* The insurer is obligated to negotiate with its insureds in good faith and to deal with them fairly. *Id.*

To establish a prima facie case of bad-faith refusal to pay an insurance claim, Lagstein must establish that the Lloyd's had no reasonable basis for disputing coverage, and that Lloyd's knew or reck-

lessly disregarded the fact that there was no reasonable basis for disputing coverage. *Powers* v. *United Services Auto. Assoc.*, 114 Nev. 690, 702-03, 962 P.2d 596 (1998), *modified on other grounds*, 979 P.2d 1286 (1999). Stated differently, an insurer fails to act in good faith when it fails, without proper cause, to compensate the insured for a loss covered by the policy. *Pemberton* v. *Farmers Ins. Exchange*, 109 Nev. 789, 793, 858 P.2d 380 (1993). "This breach or failure to perform constitutes 'bad faith' where the relationship between the parties is that of insurer and insured." *Id.*

In addition, while Nevada has often "addressed an insurer's breach of the implied covenant of good faith and fair dealing as the unreasonable denial or delay in payment of a valid claim," insurance bad faith claims are not limited to such cases. *Guaranty Nat'l. Insurance Co.* v. *Potter*, 912 P.2d 267, 272 (Nev. 1996). Rather, "[b]ad faith is established where the insurer acts unreasonably and with knowledge that there is no reasonable basis for its conduct." *Id.*; *see also Wohlers* v. *Bartgis*, 114 Nev. 1249, 1258, 969 P.2d 949, 956 (1998).[14]

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[14] In *Guaranty Nat'l.*, the insurer was sued for failing to pay for an IME it requested its insured to undergo. The insurance policy expressly provided that the IME would be paid for by the insurer. The insurer argued that an essential element of the bad faith claim was a denial or delay in payment. The Nevada Supreme Court disagreed, finding that while it often involves unreasonable denials or delay in payment, "this, however, does not mean that the tort of bad faith is limited to such cases."

2. Unfair Trade Practices Act

NRS 686A.310(1) sets forth various acts which constitute unfair claims practices, including the following:

> (a) Misrepresenting to the insured or claimants pertinent facts or insurance policy provisions relating to any coverage at issue.
>
> (b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.
>
> (c) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.
>
> (d) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.
>
> (e) Failing to effectuate prompt, fair and equitable settlements of claims in which liability of the insurer has become reasonably clear.
>
> ... .
>
> (m) Failing to comply with the provisions of NRS 687B.310 to 687B.390, inclusive, or 687B.410.
>
> (n) Failing to provide promptly to an insured a reasonable explanation of the basis in the insurance policy with respect to the facts of the insured's claim and the applicable law, for the denial of his claim or for an offer to settle or compromise his claim.

The insurer is liable to its insured for any damages sustained by the insured as a result of the commission of any act set forth in subsection 1. NRS 686A.310(2). This latter section grants a private right of action to the insured for unfair claims practices. *Humana, Inc.* v. *Forsyth*, 525 U.S. 299 (1999); *see* also *Crystal Bay Gen. Improvement Dist.* v. *Aetna CAs. & Sur. Co.*, 713 F. Supp. 1371 (D. Nev. 1989). The statute proscribes specific actions taken by an insurer which Nevada has deemed to be unfair whether or not they are related to a denial of insurance benefits. *Hart* v. *Prudential Property & Cas. Ins. Co.*, 848 F. Supp. 900, 903 (D. Nev. 1994).

Similarly, NAC Chapter 686A.600 defines certain minimum standards, "violations of which, with a frequency which indicates a general business practice, will be deemed to constitute unfair claims settlement practices." NAC 686A.600(1). For example, insurers must fully disclose to first party claimants all pertinent coverages and provisions of an insurance policy, and no agent can "conceal from a first-party claimant any of the benefits, coverages or other provisions of any insurance contract or policy when pertinent to a claim." The acts listed in the statute are not, however, exhaustive; thus, actions not specified in NAC Chapter 686A.600 may also be deemed to be violations of NRS 686A.310. NAC 686A.600(3).

B. LLOYD'S NOTICE OF NON-RENEWAL

Lloyd's issued the subject disability policy with a three year term. It was set to expire on January 15, 2002. Fourteen days after Lagstein submitted his proof of loss, on December 18, 2001, Lloyd's wrote to Lagstein, stating that it would not renew his policy because he had made a claim. Lloyd's then stated

that it would "reconsider" renewing it if he settled his claim.

Through this letter, Lloyd's insinuated to Lagstein that due to the medical disability identified in his claim, he was not insurable. Lloyd's' intention was unfairly to force settlement by threatening not to renew Lagstein's policy on its expiration unless he settled. This pressure was applied when Lloyd's had yet to state whether it intended to accept or deny his claim. Lagstein perceived this letter as meaning that he was too sick to be insured any longer, unless be compromised his claim.

It is unfair claims practice to fail to comply with Nevada's renewal statutes. *See* NRS 686A.310(m). The insurer must provide its insured with a notice of its intent to not renew a policy 30 days before it is set to expire. NRS 687B.340(I). "If an insurer fails to provide a timely notice of non-renewal , the insurer shall provide the insured with a policy of insurance on the identical terms as in the expiring policy." *Id.* NRS 687B.410 provides that for certain policies, such as health insurance policies, the insurer must provide 60 days notice of its intent not renew. Health insurance is broadly defined to include individual disability policies. *See* NRS 681A.030.

Because Lloyd's failed to give the requisite 30 and 60 day notices of its intent to not renew, it violated NRS 687B.340(1) and NRS 687.410. Lloyd's thus violated NRS 686A.310(m), an unfair claims practice.

C. LLOYD'S' INVESTIGATION INTO LAGSTEIN'S HEART MURMUR

Lloyd's spent approximately six months inquiring into and "investigating" Lagstein's heart mur-

mur, even though this condition had been disclosed by Lagstein in his application and Lloyd's underwriters had investigated it. In the underwriting of his application, Lloyd's required that Lagstein be examined by a paramedic and then a physician. The physician performed a stress test on Lagstein. Based upon the underwriting it chose to perform, Lloyd's issued the policy and accepted this condition without a rider, exclusion or limitation prior to the issuance of the policy.

Despite the foregoing, on January 9, 2002, Lloyd's' representative Patricia Melcer ("Melcer") informed Lagstein she wanted information concerning his heart murmur. Lagstein explained to Melcer that he had disclosed the heart murmur in his application, that he had self diagnosed his heart murmur and that Dr. Cohen had confirmed it.

On February 4, 2002, Lloyd's wrote to Dr. Cohen, inquiring as to whether there was any relationship between the heart murmur and the severe aortic valve disease. By this time, Lloyd's had received some of Dr. Cohen's medical records.[15] In his August 31, 2001 clinical history, Dr. Cohen noted that Lagstein had experienced some tightness in his chest, which "prompted a self examination which led to the murmur detection." On February 5, 2002, Lloyd's wrote to Lagstein's attorney, requesting the physician who first diagnosed the heart murmur. On February 27, 2002, Lloyd's again requested the "name and contact information for the physician who first diagnosed the Insured's heart murmur so that we can obtain those medical records." Lloyd's then

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[15] Lloyd's had also requested Cohen's records on January 7, 2002.

stated that it could not proceed "with claim processing until in receipt of this information."[16] On March 5, 2002, Lagstein again spoke with Melcer, and once again, Lagstein explained that he first diagnosed his heart murmur. On March 15, 2002, Lagstein's attorney confirmed this information.

On April 1, 2002, Lloyd's continued to inquire into the heart murmur, writing to Dr. Cohen, seeking whether there was any relationship between the heart murmur and aortic valve disease. On June 4, 2002, Lloyd's received a response from Dr. Cohen. On June 11, 2002, Lloyd's again wrote Dr. Cohen about the heart murmur, claiming he had failed to answer its question. In contrast, Lloyd's did not ask its IMFE doctors to determine what relationship the heart murmur had to his aortic valve disease.

On December 17, 2002, Lloyd's continued to inform Lagstein that it still did not have a response, suggesting this was a partial basis for not making a decision on the claim. In its January 3, 2003 letter, Lloyd's reiterated that Dr. Cohen had not responded and that, therefore, Lloyd's still did not have "complete medical records." On May 13, 2003, Lloyd's again represented that Dr. Cohen's failure to respond to its question concerning the relationship between the heart murmur meant that it did not have complete medical records which justified its failure to make a decision on the claim and that it would not make a decision until it was provided. Lloyd's continued to take this stance on June 13, 2003, on July

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[16] Lloyd's statement that it "could not" proceed with claims processing was also directed at its request for information concerning Lagstein's claims to "other insurers for disability benefits."

11, 2003, on August 13, 2003, and even on December 31, 2003, after Lloyd's had been sued.

Lloyd's' representations that it could not process his claim until it received this information was false, misleading and, as such, constitutes violations of NRS 686A.310(1)(a). There was no valid basis for seeking this information. Any condition related to the heart murmur could not be denied as a pre-existing condition. The policy defined a pre-existing condition as one that the insured had not disclosed on the application and for which the insured sought medical treatment before the effective date of the policy or should have. Because this condition was disclosed by Lagstein in his application for the policy, it was not an excluded, pre-existing condition. Consequently, there was no reasonable basis for Lloyd's to insist that Dr. Cohen respond to its inquiries or that it could not process the claim until it had Dr. Cohen's response.

In fact, Lloyd's' 54 page denial letter is devoid of any explanation as to how this "lack of information" concerning the heart murmur was relevant to the claim decision, At the arbitration hearing, Gleason testified that Lloyd's intent was to "find" coverage by showing that the aortic stenosis was related to the heart murmur and, therefore, not a pre-existing condition. The Panel finds that Gleason's testimony was not credible.

Instead, it appears that that Lloyd's was looking for a way to deny paying Lagstein his benefits. Lloyd's' intention was to find that Lagstein had known about his "aortic stenosis" but failed to disclose it. Lloyd's was engaged in what is commonly referred to as post-claims underwriting. Insurance companies are required to do their underwriting at

the time the policy application is made. *See Stanford* v. *Veterans Life Insurance Co.*, 1994 U.S. Dist. Lexis 21172 (1994); and *Reserve Life Ins. Co.* v. *McGee*, 444 So.2d 803 (Miss. 1983); *White* v. *Continental General*, 831 F. Supp. 1545, 1556 (D. Wyo. 1993). It is inappropriate to engage in post-claims underwriting, which is the practice of conducting a thorough underwriting only *after* the policy is issued and a claim has been submitted. *Id.* Stated differently, post-claims underwriting is where the insurer waits until after the insured makes a claim to determine whether the claimant is eligible for insurance according to the risks he presents. *Lewis* v. *Equity Nat'l. Life Ins. Co.*, 637 So.2d 183, 188-89 (Miss. 1994). Post-claims underwriting is inappropriate:

> An insurer has an obligation to its insureds to do its underwriting at the time a policy application is made, not after a claim is filed. It is patently unfair for a claimant to obtain a policy, pay his premiums and operate under the assumption that he is insured against a specified risk, only to learn *after* he submits a claim that he is not insured, and, therefore, cannot obtain any other policy to cover the loss. The insurer controls when the underwriting occurs. It should therefore be estopped from determining whether to accept an insured six months or more after a policy is issued. If the insured is not an acceptable risk, the application should [be] denied up front, not after a policy is issued. This allows the proposed insured to seek other coverage with another company since no company will insure an individual who has suffered serious illness or injury.

Lewis, 637 So.2d at 188.

D. THE INDEPENDENT MEDICAL EXAMINATIONS

On April 17, 2002, nearly four months past the date Lloyd's was required to accept or deny the claim, Lloyd's requested that Lagstein undergo two IMEs: one by a cardiologist and another by a neurologist.[17] Lloyd's did not provide any reason for the need for these IMEs. Lloyd's' claim file is devoid of any medical review by a medical doctor which indicated that an IME was necessary to clarify issues about Lagstein's medical condition. In fact, the only information which Lloyd's had was from Lagstein's treating physicians who had certified his medical disability. Lloyd's' request to conduct the IMEs was improper in that it was designed to delay paying the benefits which were due and, secondly, to look for some way to deny the claim. In fact, two months after Lagstein agreed to the IMEs, Lloyd's had not scheduled them.

On August 28, 2002, Lagstein underwent an IME with Dr. Chanderraj, a cardiologist. Lloyd's also scheduled an IME with Dr. Gott, a neurosurgeon. Lagstein objected to this IME. in that he felt a neurologist was more qualified than neurosurgeon. In response, Lloyd's stated that Dr. Gott was clearly

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[17] This request came in response to Lagstein's attorney forwarding on April 12, 2002 copies of medical records for a hospitalization which Lagstein had on April 5, 2002 through April 6, 2002. Those records showed that he had suffered from atrial fibrillation and flutter, conditions precipitated by psychological stress, premature atrial ectopic activity, and premature ventricular contractions. These records further confirmed Lagstein's disability.

"qualified to assess Dr. Lagstein's history and current status with regard to migraines, chronic fatigue, as well as cervical neuropathy, even though the last condition may not be contributing to his disability."

Consequently, on September 4, 2002, Lagstein submitted to an IME with Dr. Gott. In his September 4, 2002 IME report, Dr. Gott found that Lagstein was totally permanently disabled:

> You inquired further on 8/14/2002 whether the patient could perform other professional medical duties. Given the overall complexity of this man's history, his-numerous alarming responses to stressful situations such as severe headaches, light-headedness, tachycardia, etc. and his polypharmacy (24 medications in the list, including coumadin for anticoagulation), this patient cannot be expected to perform regularly in any medical capacity. Would you want this man working on your heart, or making decisions and providing your medical care?

In addition, Dr. Gott emphasized that "in his professional opinion that the patient [wa]s not able to return to work as a practicing clinician" and that Lagstein had reached his maximum medical improvement.

On September 11, 2002 and September 17, 2002 Lagstein requested copies of the IME reports. On October 7, 2002, Lagstein requested that Dr. Chanderraj's IME report be provided to Lagstein's cardiologist. While it is standard practice to provide copies of the IME reports to the claimant's physicians or their representatives, on October 8, 2002, IRMG informed Lagstein that IMEs were "privileged work product

and that it could not release them without Lloyd's' approval. *See Rawlings* v. *Apodaca*, 726 P.2d 565, 573 (Ariz, 1986) (an insurer's failure to comply with industry standards may be relevant to the question of an insurer's alleged bad faith.) Moreover, Lloyds was obligated by Nevada law to provide a certified copy of the IME report "to the primary treating physician or chiropractor and the insured person within 10 working days after the evaluation." NRS 689A.0403(3).

IRMG's representations were false and, as a result, a violation of NRS 686A.310(1)(a). Under oath Gleason admitted that she had complete authority to make the decisions on the claim and did not have to report to anyone at Lloyd's. Therefore, she did not need Lloyd's' permission to provide Lagstein with copies.[18] Her false statement was a stall tactic: Lloyd's withheld these reports because Dr. Gott had confirmed that Lagstein was totally permanently disabled. Furthermore, these IMEs were conducted as a part of the claims processing not in anticipation of litigation or at the direction of Lloyd's' attorney.[19] The IMEs were not "work product." In fact, four

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[18] Similarly, when Lagstein requested a copy of Lloyd's' private investigator's reports, Gleason falsely responded that she could not forward it without Lloyd's' permission. Gleason even stated that "We will forward the request for this to [Lloyd's] and advise you accordingly of their instructions." The claim file lacked any such request.

[19] While Gleason testified that after this lawsuit was filed, she wore both the hat of an adjustor for Lloyd's and that of an individual legal counsel, the IMEs were ordered by IRMG prelitigation during the processing of this claim before any retention of Gleason in her individual capacity as an attorney for Lloyd's.

months after this lawsuit was filed, Lloyd's produced the IMEs and referred to the IME's doctors' opinions in Lloyd's' denial of this claim.

Dr. Chanderraj's IME report is dated September 17, 2002. Dr. Chanderraj concluded that Lagstein was disabled from the medical profession as of the date of the IME. However, Lloyd's did not ask Dr. Chanderraj to determine if Lagstein was disabled in October 2001, when he made his claim.

Lloyd's continued to make misrepresentations to Lagstein. On October 8, 2002, Lloyd's misrepresented to Lagstein that it had not received the "final" IME reports, when, in truth, Lloyd's had received both of the IME reports. Dr. Gott's September 12, 2002 report was faxed to Lloyd's on September 12, 2002 at 9:24 a.m. Dr. Chanderraj's September 17, 2002 report was faxed to Lloyd's on either September 18, 2002 or September 19, 2002.[20]

As of October 8, 2002, it appears that Lloyd's was engaged in tactics to persuade Dr. Gott to change his opinions because, in part, in the words of the Lloyd's representative, the IME reports were "conflicting." Lloyd's instructed the IME doctors to exchange their reports and issue "addendums." In so doing, these doctors ceased to be "independent" medical examiners. Based upon Lloyd's' manipulation of the neutrality of its IME doctors, the Panel does not give Dr. Gott's addendum any weight and further finds that his original IME report reflects his actual opinions

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[20] Lloyd's refused to produce copies of the IME reports until December 31, 2003, nearly four months after Lloyd's had been served with Lagstein's Amended Complaint, where Lloyd's had been sued for bad faith, breach of contract and violations of Nevada's Unfair Claims Practices Act.

before any outside influences tainted him. Dr. Gott is now a practicing attorney rather than working as a doctor.

On December 17, 2002, Lloyd's requested that Lagstein undergo yet another IME, this time with an out-of-state neurologist. At the time, Lloyd's had not provided Lagstein with copies of either of the IME reports, despite Lagstein's repeated requests. Instead, when Lagstein objected to submitting to yet another IME, Lloyd's stated it had the right to examine him at any time during the pendency of the claim and that if he failed to comply, it could adversely prejudice his claim for benefits.

Lloyd's' attempts to subject Lagstein to yet a third IME violated the express terms of the subject policy, where it provided as follows:

> Benefits will be paid if it is determined by the physician providing your regular care that you are permanently totally disabled. We reserve the right to have you examined by a physician of our choice. ***Should your physician and our physician not be able to agree that you are totally disabled, your physician and our physician shall name a third physician to make a decision on the matter which shall be final and binding.*** (Emphasis added.)

Three months before this December 17, 2002 date, Lloyd's knew that its IME physician Dr. Chanderraj disagreed with Lagstein's treating cardiologists who had opined that he was totally disabled from a cardiology standpoint, and with Dr. Bernick's findings concerning the migraine headaches. Pursuant to the express terms of the policy, this disagree-

ment triggered the referee provision, whereby Lagstein's physician and Lloyd's' physician "name a third physician to make a decision on the matter" which would have been *binding* on the parties. Rather than inform Lagstein of the referee provision and comply with it, Lloyd's misrepresented that Lagstein must undergo the third IME by a neurologist of its choosing or face having the claim denied for "failing to cooperate." Lloyd's' actions are clear evidence of bad faith conduct and further violations of NRS 686A.310(1)(a) and NAC 686A.660(1) – (2).

Furthermore, when Lloyd's ignored the referee provision and attempted to force a third IME, Lloyd's was attempting to rewrite the policy or insist upon terms which did not exist. Such conduct constitutes an anticipatory repudiation of the subject disability policy. *See United California Bank* v. *Prudential Ins. Co. of America*, 681 P.2d 390, 428 (Ariz. Ct. App. 1984) (insistence by one party of terms not contained within contract constitutes "anticipatory repudiation"). Notably, it is irrelevant whether a party repudiates its contract obligations on the basis of an alleged "contract interpretation" or for some other reason; rather, the insistence upon terms which are not contained in a contract constitutes an anticipatory repudiation thereof. *Id.* at 429. "If one party to a contract, either willfully or by mistake, demands of the other a performance to which he has no right under the contract and states definitely that, unless his demand is complied with, he will not render his promised performance; an anticipatory breach has been committed." *Id.* at 431.

E. LLOYD'S' JULY 29, 2005 DENIAL LETTER

It took Lloyd's three and one-half years or 1,333 days to deny Lagstein's claim, when on July 29, 2005, Gleason sent a 54-page letter, denying his claim. Lloyd's had no reasonable basis to deny the claim, let alone take three and one-half years to inform Lagstein of its intent to deny it. The Panel finds that Lloyd's denied Lagstein's claim in bad faith and that Lloyd's' intentionally violated its implied and statutory obligations concerning the handling of this claim.

1. Lagstein's Illnesses Caused Total Disability

Ignoring the fact that Lloyd's' treating physicians certified that he was disabled due to his various cardiac and neurological conditions, Lloyd's contended that Lagstein failed to demonstrate that an illness caused his disability and that he "did not clearly delineate which disabling conditions resulted from which instances." Lloyd's' position was unreasonable, unfounded and contrary to the extensive medical evidence.

2. The Elimination Period Had Been Met

On July 29, 2005 -- for the first time in the history of this claim, Lloyd's informed Lagstein that his claim was being denied because he did not meet the 90-day elimination period. Ignoring the facts, Lloyd's represents that the onset date of Lagstein's disability was November 21, 2001, instead of October 23, 2001. Lloyd's thus rationalized that because Lagstein resumed some professional activities on February 8, 2002, he was only disabled for 77 days, not the required 90 days

Lloyd's' position was untimely and unfounded. Lagstein clearly met the elimination period. In their December 2001 Attending Physician Statements, both Drs. Cohen and Bernick certified that Lagstein's disability commenced on October 23, 2001.[21] Lagstein's proof of loss provided the same date because that was the date he stopped working. Moreover, Dr. Cohen's records confirmed that Lagstein was disabled as of October 23, 2001.[22] Dr. Cohen diagnosed the aortic stenosis in August of 2001 and recommended he undergo open heart surgery. In a letter dated November 6, 2001, Dr. Cohen stated:

> I advise Dr. Lagstein to retire from the practice of medicine. He should be considered totally and permanent disabled beginning 08/31/2001 (the date of the heart catheterization which confirmed the severity of the aortic stenosis and at which point it was discovered that he was more symptomatic than first it appeared).

Lagstein informed Lloyd's that he stopped working on October 23, 2001. When Lloyd's subjected him to surveillance and then an unscheduled, surprise visit by a field investigator hired by Lloyd's, the investigator confirmed with Lagstein's staff that Lagstein had canceled all of his appointments from October 23, 2001 to February 8, 2002. In fact, on May 2, 2002, the field investigator informed Lloyd's that:

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[21] Lagstein's counsel forwarded some of Dr. Cohen's records in early January 2002. Lloyd's received a complete set of Dr. Cohen's records from Dr. Cohen's office on June 4, 2002.

[22] Lagstein's counsel forwarded some of Dr. Cohen's records in early January 2002. Lloyd's received a complete set of Dr. Cohen's records from Dr. Cohen's office on June 4, 2002.

> The insured advised all appointments from 10/23/02 to 2/8/02 were cancelled and re-scheduled due to his disability. Edna, his front office clerk, confirmed the same.

When Lloyd's subjected Lagstein to the two IMEs, Lloyd's did not request that its physicians determine what the onset of Lagstein's disability was.

Despite the foregoing, Lloyd's argued that the onset of his disability was November 21, 2001, the date that he underwent the open heart surgery in Texas. Lloyd's cannot support this position. First, Lloyd's contended that Lagstein testified in a deposition (in his case against Paul Revere) that "this open heart surgery was the beginning of your [your] disability, and that this occurred in October 2001."[23] Lloyd's then reasoned that Lagstein actually had surgery on November 21, 2001 and that, therefore, his disability commenced then. Lagstein's deposition testimony does not support such a conclusion:

> Q. Before October 23rd of 2001, were you able to work – continue to work doing noninterventional procedures?
>
> A. Before October of 2001?
>
> Q. Yes.
>
> A. Yeah. I was working in the office.
>
> Q. Then beginning October 23rd , you said you went in for this surgery; is that correct?

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[23] Lagstein's disability policy issued by Paul Revere was different from the policy which is the subject of this arbtitration. Paul Revere insured Lagstein in the event he became disabled from his specialty of interventional and invasive cardiology.

A. Correct.

Lagstein did not testify as Lloyd's would have the Panel believe. As Lagstein explained, he had mistakenly agreed that his heart surgery was on October 23, 2001. However, he did not testify, nor was it reasonable to conclude from his testimony, that his disability began when he had the surgery. In order to reach its conclusion, Lloyd's had to ignore all of the independent facts which showed that Lagstein had stopped working on October 23, 2001, including his treating physicians' statements, the medical records and Lloyd's' own private investigator's findings.

Secondly, Lloyd's incorrectly contended that Lagstein's physicians disagreed as to when he became disabled. They did not: they both certified that he was permanently disabled as of October 23, 2001. Lloyd's clings to Dr. Cohen's Attending Physician Statement, which provided next to his diagnoses that the onset date was November 21, 2001. Dr. Cohen's notation was directed at the date Lagstein had his surgery and several complications, not the onset date of his disability. If Lloyd's had any questions, it should have contacted Dr. Cohen directly for clarification. Lloyd's did not, however, because it knew that Dr. Cohen believed Lagstein was permanently disabled well before November 21, 2001. Lloyd's had already obtained Dr. Cohen's records, where he stated he should be considered disabled as of August 2001.

The Panel becomes impatient with Lloyd's' persistent attempt to persuade it that the disability commenced on November 21, 2001. The unreasonable nature of Lloyd's' position is highlighted by Gleason's April 2006 deposition testimony (introduced at the hearing), when she could not even con-

cede that if his date of disability commenced on October 23, 2001, he would have been considered disabled:

> If his date of disability is October 23, 2001, does he meet the elimination period on the facts in this case?
>
> MR. RIMAC: Object. The question's vague and ambiguous, improper hypothetical, assumes facts not in evidence, requires speculation from the witness. It's argumentative.
>
> THE WITNESS: We don't have enough information to even really determine that.

In addition, even if there had been a good faith argument that Lagstein's disability began on November 21, 2001, the Panel finds that he met the elimination period because his return to work was against the advice of his doctors and caused by financial stresses. Lloyd's admitted in its denial letter that Lagstein had provided "information that supports a claim that [he] became totally disabled under the terms of the Policy on 21 November 2001, that said disability lasted through 7 February 2002 ... ." As previously found by this Panel, Lagstein's return to work in February of 2002 did not demonstrate that he had lost his disability status. In other words, because he was "working disabled," he continued to be disabled and met the elimination period.

In the eyes of the Panel, there is absolutely no credible evidence to challenge the plain fact that Lagstein's disability began on October 23, 2001.

3. Lagstein Did Not Make a Claim for Residual Disability

Lagstein never made a claim for residual disability. Yet, in its denial letter, Lloyd's states that he "failed to provide any tax documents for tax year 2002" to prove a claim for residual disability. Lloyd's contended that Lagstein's failure to cooperate in providing documents for a claim which he did not make, justified its delay in denying his claims and that "any action brought over the policy must be dismissed." Lloyd's reiterated that "your refusal to cooperate with the investigation and provide the requested information is an independent reason to deny your claim for residual disability benefits, *and is a defense to your legal action*." (Emphasis added).

This representation by Lloyd's was without merit. In fact, it is further indicia of Lloyd's' bad faith. Lagstein had not "failed to cooperate" when he failed to produce documents in response to a claim he did not make. Simply put, he did not make a claim for residual disability and, therefore, he had no duty to respond to Lloyd's' request for information on this non-existing claim. None of the cases cited by Lloyd's stood for the proposition that Lagstein's lawsuit regarding Lloyd's' failure to pay benefits *on the claim which he did make* could be dismissed because he did not produce documents to support a claim *which he did not make*. Lloyd's' representations were false.

In addition, the insurance policy provided that Lagstein could only obtain residual disability benefits if he met the 90-day elimination period, which Lloyd's contended he had not met. Since it was Lloyd's' position that he had not satisfied the elimination period, Lloyd's knew that it would not accept a claim for residual disability. Lloyd's request for the

financial information was not made in good faith. It was yet another ploy to delay denying the claim. Lloyd's' conduct can hardly be considered a mistake, as it requested this information a total of eight times after December 17, 2002 and repeatedly misrepresented that it could not process Lagstein's claim until the information was provided.

4. Lagstein's Other Insurance with Paul Revere:

In Lloyd's' July 29, 2005 denial letter, Lloyd's states that Lagstein failed to provide information concerning other claims which he had with other insurers for disability benefits. Lloyd's repeatedly misrepresented to Lagstein that it needed this information to proceed with the claim.

On January 9, 2002, Lloyd's stated that it needed details of all claims that Lagstein had submitted with other insurers. Lagstein had already informed Lloyd's that the only other individual disability policy which he had was with Paul Revere. In his December 4, 2001 proof of loss, Lagstein identified this policy along with the policy number. Lagstein's representation was true. Lloyd's failed to inform Lagstein why it needed this information or why it could not obtain it through the written authorization. Notably, it is standard practice for the insurer to independently obtain all information directly from the other insurance companies. Lloyd's' failure to independently request this information from Paul Revere is yet another indicia of its bad faith. *See Rawlings*, 726 P.2d at 573.

On February 5, 2002, Lloyd's again requested the information without stating why it needed it. On February 27, 2002, Lloyd's then represented that it

could not proceed further with the claim processing until it had received the information. This representation was not truthful.

On June 27, 2002, Lagstein wrote to Lloyd's, asking "what is it that stops Lloyd's from paying benefits for the period I was very ill by all accounts?" Lloyd's did not respond to his inquiry, as required by NRS 686A.310(1)(b). When Lloyd's next wrote to Lagstein on August 1, 2002, Lloyd's only discussed issues relating to the scheduling of IMEs; it did not state how the "other insurance" information was relevant. On October 8, 2002, Lloyd's wrote, stating it was awaiting details of Lagstein's activities in the medical profession. Once again, there was no mention of the other insurance information.

The first time that Lloyd's provided its explanation for seeking this information was more than one year after the claim had been made. Specifically, on December 17, 2002, Lloyd's contended that it needed the information from Paul Revere because his policy had a Relations to Earnings endorsement, where his cash benefit could not exceed 65% of his average earned monthly income.[24] Based upon this endorsement, Lloyd's contended that "On your claim form you reported that you also had insurance through Paul Revere Insurance. Therefore, we will need copies of those policies and evidence of payments that Paul Revere Insurance has made to you, or evidence that it has not made any payments to you."

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[24] Every endorsement must be identified by a number in the lower left-hand corner of the first page thereof. NRS 689A.030(6). This endorsement fails to comply with the statute.

The Relation of Earnings to Insurance Endorsement, provided in part:

> To calculate the ration between earned income and cash disability benefits, earned income will be calculated as an average of monthly earned income for the twelve month ***period immediately preceding*** the date of the first medical attention rendered for the injury or illness that resulted in your disability, less any time during the twelve (12) month period that you may have been disabled for this cause or another cause, and cash disability benefits will be a compilation of all benefits available to you at the time of the claim. (Emphasis added.)

Despite the written authorization it had, Lloyd's had not made any attempt to request the information directly from Paul Revere. Moreover, Lloyd's did not need any additional information. Lloyd's knew that the total monthly benefit was only $18,000 (which could have been easily confirmed through Paul Revere). Lloyd's further knew what Lagstein's prior income had been in that Lagstein had forwarded pre-disability financial records in December of 2001. In its denial letter, Lloyd's stated that his average income was over $1 million and that, therefore, his "allowed maximum monthly benefit from all sources under the Policy would be approximately $58,216.57." Assuming that the endorsement was legally valid, Lloyd's did not need any additional information to analyze the endorsement. The total of Lloyd's benefit ($15,000) and the total of Paul Revere ($18,000) was well below the $58,216.57 maximum amount. Therefore, the total amount of Lloyd's' benefit was due and payable and Lloyd's did not need the

additional information. NRS ,689A.410(3) prohibits such conduct, which provides that "An insurer shall not request additional information to that which the claimant has already provided to the insurer, unless the insurer provides a legitimate reason for the request and the purpose is not to delay the payment of the claim, harass the claimant or discourage the filing of claims."

Notwithstanding, in its denial letter, Lloyd's misrepresented to Lagstein that he had failed to provide all of the necessary information:

> If you were entitled to benefits, which you are not, to determine your amount of benefits, Underwriters needed your complete financial information and the amount of benefits or other collectible insurance you received. You provided pre-disability-claim tax documents, but, as you did with Paul Revere matter, refused to provide post-claim tax documents. You failed to provide this requested financial information, and failed to provide the requested information re the amount of benefits or other collectible insurance you had received.

Lloyd's then informed Lagstein that because he had not provided the "post-claim tax documents," and the information regarding other disability claims, Lloyd's could "conclude that this information would not have supported your claim for disability benefits." The Panel disagrees. The endorsement does not calculate the 65% based upon "post-claim" income. Instead, the calculation is made based upon pre-disability income and identified the total amount of his Paul Revere benefits, which had been provided to Lloyd's in December of 2001 – three and one-half years earlier.

5. Failure to Submit to Third IME

As previously discussed, Lloyd's' demand that Lagstein submit to a third IME was unreasonable and in contravention of the policy's referee provision. Lloyd's' denial of the claim for "lack of cooperation" is unfounded and without any reasonable basis.

F. LLOYD'S FAILED TO ENACT REASONABLE PROCEDURES

NRS 686A.310(1)(a) mandates that an insurer must "adopt and implement reasonable standards for the prompt investigation and processing of claims ... ." As Lagstein's claims handling expert testified, this is often accomplished by the insurer developing a written claims manual which is then implemented through a properly maintained claims file.

In this case, Lloyd's had no claims manuals or instructional materials which set forth reasonable protocols for conducting a prompt investigation or which identified the relevant time frames which it had to comply with Nevada' statutory requirements for accepting or denying a claim.

In addition, its claims file failed to comply with industry standards. A claim file in a first party insurance claim should accurately reflect what has occurred and the rationale of the insurance company in making its decisions. Stated differently, anyone picking up the claim file should be able to know what is happening with the claim, what questions the insurer has, why the questions exist, and what the plan is to resolve those questions. It is generally accepted principle that if it is not in the claim file, it did not happen. In this case, the claim file was missing documents, lacked appropriate documentation of

what had transpired, and failed to reflect Lloyd's' rationale behind its decisions.

The claim file lacked any explanation as to why for eight months Lloyd's was pursuing the heart murmur information. It lacked any medical review prior to the request for an IME, it lacked any indication as to why there was a need for an IME or why Dr. Gott's September 12, 2002 IME was not accepted. The claim file failed to record each of the material conversations between Lloyd's and Lagstein. From the evidence, the Panel finds that documents were missing from the claim file.

Lloyd's has clearly violated NRS 686A.310(1)(c).

G. LLOYD'S FAILED TO INVESTIGATE RELEVANT FACTS WHICH WOULD HAVE SUPPORTED COVERAGE

Lloyd's failed to investigate all of the relevant and applicable facts of Lagstein's claim and instead focused on finding ways to deny coverage. It failed to conduct a fair, objective and thorough evaluation of the claim to determine whether coverage was supported. Lloyd's failed to conduct a fair and objective investigation into (a) Lagstein's claim that his migraine headaches caused him to become totally disabled from the medical profession; (b) the potential effect which the polypharmacies had on Lagstein and how it was further disabling to Lagstein, such as: (i) speaking to his treating physicians about the dosages, frequency of medications and side effects; (ii) speaking with the insured about his symptoms; (iii) investigating the fatigue and confusion associated with the pain medications and cardiac medications; (iv) investigating the anti-depressant medications; (c)

Lagstein's comorbid[25] conditions, including whether Lagstein's treating cardiologist and neurologist were co-ordinating their treatment, or the impact of the medications; or, (d) Lagstein's depression.

Lloyd's claimed that it had questions about Lagstein's doctor's certification of his claim. According to Lagstein's claims handling expert, when an insurer believes that what is given on the proof of loss form is insufficient to support the determination that the insured is disabled, it is standard practice for the insurer to ask the treating physicians directly to clarify those questions. Lloyd's did not.

H. LLOYD'S FAILED TO TREAT LAGSTEIN'S INTEREST EQUAL TO ITS INTEREST

Lloyd's failed to treat, or even consider, Lagstein's interest equal to its interest. In responding to questions about the duties which an insurer has under the implied covenant of good faith and fair dealing, Gleason improperly reacted as though this was an absurd principle, when she testified as follows:

> Q. To give the insured consideration equal to that of the insurance company's interests?
>
> A. What is your question?
>
> Q. To give the insured equal consideration?
>
> MR. RIMAC: Object. The question is vague and ambiguous. Is that part of what your [sic] saying is the duty of good faith and fair dealing?

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[25] Comorbid is a term referring to a claim which had more than one condition occurring at once.

> MR. SURRANO: Yes.
>
> THE WITNESS: ***I'm sorry I laughed but it's not something I really thought about I guess.***
>
> MR. RIMAC: We're going to take a break for a second.
>
> MR. SURRANO: She's not done answering the question.
>
> MR. RIMAC: No, we're taking a break. (Emphasis added).[26]

Throughout the handling of this claim, Lloyd's placed its interest above those of Lagstein's. Lloyd's' sole focus was finding a way to deny this claim.

I. LLOYD'S REPEATEDLY DEMANDED INFORMATION WHICH WAS NOT RELEVANT TO DELAY ITS PROCESSING OF THIS CLAIM

As previously discussed, throughout the handling of this claim. Lloyd's demanded information from Lagstein which was not relevant under a guise that until it was received, the claim could not be "finalized" or processed. This included Lloyd's' request for the relation between the heart murmur and the aortic stenosis, and the information on Lagstein's Paul Revere disability policy. Neither was necessary to properly determine whether the benefits should be paid.

Likewise, Lloyd's demanded information about Lagstein's "duties" which should have had no bearing

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[26] This testimony came from Gleason's deposition, which was introduced by Plaintiff.

on this claim. In 2000, Lagstein began focusing his practice on nuclear cardiology, as opposed to his invasive cardiology. Assuming that Lloyd's' failure to comply with 689A.030(6) did not void this endorsement, his medical specialty was irrelevant to whether he was disabled under Lloyd's' policy because Lloyd's' policy required that Lagstein be unable to perform the material and substantial duties of the medical profession, not just his specialty of cardiology.[27]

Despite the irrelevance, Lloyd's required the IME doctors to determine whether he was disabled as an "interventional cardiologist." Lloyd's requested Lagstein to provide details as to his duties in the medical profession. In October 8, 2002. Lloyd's wrote, stating it had requested on numerous occasions the details of Lagstein's activities in the medical profession since August 30, 2001. Lloyd's then informed Lagstein that until that information was received it could not reach a final determination on his claim.

At the arbitration, Gleason testified as follows:

> ARBITRATOR WHITEHEAD: Is it your position that he was permanently disabled from a[n] interventional cardiologist but could be a general practitioner, that he would receive full pay or would he not be eligible?
> THE WITNESS: We were willing to be reasonable at that point.
>
> ARBITRATOR WHITEHEAD: But I mean, what was your – if he could do nuclear medi-

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[27] Because the Panel finds that Lagstein was medically disabled from the medical profession, it does not deem it necessary to determine whether the endorsement became void.

cine but couldn't do invasive cardiologist, would that make a difference to you?
THE WITNESS: It would.

ARBITRATOR WHITEHEAD: What would the result have neen?
THE WITNESS: We would have then asked for further definition of what his activities and duties – what he was capable of doing. In fact, that's actually what we asked him to provide too.

ARBITRATOR WHITEHEAD: That's perhaps what I – maybe I'm misunderstanding. I thought your position was if he could do any duties of – as a physician, that he wasn't eligible?
THE WITNESS: That is the definition of total disability.

ARBITRATOR WHITEHEAD: So if that's the case, what difference does it make whether he's an invasive cardiologist or some other physician?
THE WITNESS: We actually trying to get an answer on what he was able to do and –

ARBITRATOR WHITEHEAD: But if it had come back and said, he can't be an invasive cardiologist but he could be – do nuclear medicine, would you have paid him?
THE WITNESS: I think it would depend on what activities and amount of duties he could perform in nuclear medicine.

ARBITRATOR WHITEHEAD: Let's say he worked 40 hours a week as a nuclear physician.

> THE WITNESS: That probably would make him ineligible for benefits.
>
> ARBITRATOR WHITEHEAD: So it really wasn't significant whether he was an invasive cardiologist or not. What was significant is –
> THE WITNESS: Probably not so much emphasis I was putting on it at the time.

In short, this information was irrelevant. The only question was whether he was disabled as a physician. In an effort to delay making a decision on this claim, Lloyd's' falsely represented that it could not process it until Lagstein provided the details of his activities.

J. LAGSTEIN DID NOT MAKE ANY MATERIAL MISREPRESENTATIONS TO LLOYD'S

Lloyd's attempts to condone its conduct as "reasonable" because Lagstein failed to immediately inform Lloyd's that he had resumed some of his professional activities, and because he certified with HealthSouth Rehab Hospital that he was in good health. The Panel disagrees.

Normally, if there is a misrepresentation by an insured to an insurance company, it is a fact question whether the variance between the representation and the existing facts was material. *Powers* v. *United Service Auto. Assoc.*, 114 Nev. 690, 697, 962 P.2d 596 (1998), modified, 115 Nev. 38, 979 P.2d 1286 (1999). The Panel notes that Lagstein did not make any affirmative misrepresentation to Lloyd's. Instead, he failed to inform Lloyd's that he had resumed some of his professional activities and, secondly, he had checked a box his application to HealthSouth Hospital, stating he was in good health.

As discussed above, Lagstein resumed some limited professional activities because Lloyd's failed to accept his claim and acknowledge that his disability benefits were forthcoming. Lagstein's resumption of these activities was against the advice of his doctors. Lagstein's failure to immediately inform Lloyd's that he had resumed these activities was not a material misrepresentation. Indeed, Lloyd's was aware in April of 2002 that he had resumed them, and in May of 2002 Lloyd's had a report from its field investigator confirming that he had resumed those activities. Yet rather than deny his claim upon receiving this information, Lloyd's waited an additional three years before denying it on the grounds he had failed to meet the elimination period.

Lloyd's goes to considerable effort to attack Lagstein's credibility, principally on the basis that Lagstein checked a box on his application for HealthSouth, which provided that he was in good health. The Panel finds, however, that Lagstein was very credible. While he checked the box on the application, it was done as a matter of survival. He admitted that he did it, which went against his morals, not to mention placed him at risk of losing his medical license. However, as discussed above, he needed to resume some of his professional activities to salvage his impending financial ruin.

The Panel finds that the application to HealthSouth Hospital was not a material misrepresentation to Lloyd's.

IV.
REPUDIATION OF POLICY

As discussed above, Lloyd's' attempt to rewrite the policy constitutes a repudiation of the policy. The

Panel further finds that Lloyd's' bad faith conduct is further grounds to find that the policy was repudiated. *See DeChant* v. *Monarch Life Ins. Co.*, 554 N. W.2d 225 (Wis. App. 1996). In finding that Lloyd's knowingly launched a deceptive scheme of delay with an intention of depriving Lagstein of benefits due to him under the contract, the Panel is compelled to find further that Lloyd's repudiated the contract.

V.
LLOYD'S' CONDUCT WAS MALICIOUS, OPPRESIVE, FRAUDULENT AND IN CONSCIOUS DISREGARD OF LAGSTEIN'S RIGHTS

Pursuant to NRS 42.005, where it is shown by clear and convincing evidence that the defendant "has been guilty of oppression, fraud or malice, express or implied," the plaintiff may recover punitive damages. NRS 42.005(1). Punitive damages are designed to punish and deter malicious and oppressive conduct. *Siggelkow* v. *Phoenix Ins. Co.*, 109 Nev. 42, 44, 846 P.2d 303 (1993). Nevada's statutory limits on punitive damages are not applicable to an insurer who acts in bad faith regarding its obligations to provide insurance coverage." NRS 42.005.

Oppression is defined as the conscious disregard for another's rights which constitute an act of subjecting plaintiffs to cruel and unjust hardship. *Guaranty Nat'l. Ins. Co.* v. *Potter*, 112 Nev. 199, 912 P.3d 267, 273 (1996). In *Granite Construction* v. *Rhyne*, 107 Nev. 651, 817 P.2d 711 (1991), the Court concluded that a construction company's conscious and deliberate disregard of known safety procedures justified an award of punitive damages. The majority concluded that it constituted implied malice under NRS 42.005 (formerly NRS 42.010).

In *Clark* v. *Lubritz*, 113 Nev. 1089, 944 P.2d 861 (1997), a firm of doctors were sued by one of their members for breach of fiduciary duty. The jury awarded punitive damages against appellants based upon a breach of their fiduciary duties. On appeal, appellants contended that that there had been no showing of oppression, fraud or malice to support the jury's punitive damage aware. In addressing this issue, the Court stated that:

> Under NRS 42.001(3), "express malice" is "conduct which is intended to injure a person"; "implied malice" is "*despicable conduct which is engaged in with a conscious disregard of the rights ... of others.*" In this case, there is strong evidence that a conscious decision was made not to inform Lubritz [respondent) about the decision to reduce Lubritz's share. For many years appellants "pocketed as profit," a disproportionate distribution, by reducing Lubritz's share and not telling him about the reduction. In addition, appellants conceded that the decision not to inform Lubritz of the unequal year-end distribution was "not unconscious or accidental."

Id. (Emphasis added.) Several of the appellant doctors testified that they should have made appropriate disclosures to respondent.

> We conclude that the foregoing is sufficient evidence upon which to base a finding of express malice -- that the appellants acted with intent to injury Lubritz. *Even if there were not clear and convincing evidence of intent to injure, there is certainly clear and convincing evidence here of implied malice in the form of*

> *"despicable conduct" accompanied by a "conscious disregard of the rights" of Lubritz.*

Id. (Emphasis added.) This, concluded the Court, was ample evidence to support a punitive damage award for malice. *Id.*

The Panel expressly concludes, based on clear and convincing evidence, that Lloyd's is guilty of oppression, fraud and malice and that Lagstein is, therefore, entitled to recover punitive damages against Lloyd's.

The facts of this case present a picture of aggravated oppression. Etymologically, being *oppressed* means being *weighed down* upon by the unjust use of *power*. The Panel concludes that Lloyd's with its greatly superior economic power pressed or "weighed down upon" Lagstein, tantalizing him with false expectations of payment and grinding him into a position in which he was forced to go back to work contrary to physicians' advice and forced, even, to misrepresent himself in his application to HealthSouth in order to try to survive financially.

Throughout the handling of this claim, Lloyd's misrepresented that it needed information to process the claim, even though the requested information was wholly irrelevant to the determination of whether he was eligible for his benefits. Lloyd's learned through various sources that Lagstein was in dire emotional and financial straits. Although he was in one of the most vulnerable states of his life, Lloyd's delayed and delayed the "finalization" his claim, with the clear intent of either forcing him back to work or, arguably, allowing him to die before his benefits were paid. Lagstein was in a lose-lose situation: he could return to work to pay his bills and be

consid-ered not disabled by Lloyd's or he could sit idly by as no income came in, waiting for the benefits which Lloyd's never intended on paying.

In contrast, by unreasonably delaying making its decision on this claim, Lloyd's was in a win-win situation. Lloyd's knew that the longer it took to make a decision, the more likely its insured would become financially pressured into going back to work, en-abling Lloyd's to deny the claim. If, for example, the insured returns to work and dies, Lloyd's would deny the claim because of his death. If, however, the insured goes back to work and lives, Lloyd's denies the claim on grounds the insured is no longer considered disabled. Lloyd's conduct in this case was outrageous. The evidence is very disturbing. As stated by the Nevada Supreme Court in *Ainsworth* v. *Combined Ms. Co. of America*, 104 Nev. 587, 763 P.2d 673, 677 (1988):

> [I]nsurance is a special kind of commercial activity. The insurer is under a duty to treat its policyholders fairly. The obstinate, unjustified refusal to pay a legitimate claim is offensive to society, precisely because the consumer pays for insurance to gain security and peace of mind.

Gleason testified that she was familiar with Nevada's Unfair Claims Practices Act and had a copy available to her when this claim was adjusted. In light of the multiple violations of NRS 686A.310, this testimony confirms what the evidence has demonstrated, namely, that said violations were intentional and a pattern and practice of Lloyd's. Indeed. Gleason testified that Lloyd's treated Lagstein the same way it has treated other claimants in Nevada and

that it would continue to treat future claimants in the same way.

VI.
DAMAGES

The Panel has decided that Lloyd's is liable to Lagstein for breach of its insurance contract. The Panel has also decided that Lloyd's has been guilty of tortious conduct in the form of breach of the covenant of good faith and fair dealing and in its violation of Nevada's Unfair Trade Practices Act. Lagstein is entitled to recover damages for the breach of the contract and to recover special and general damages in tort. The Panel also decided that Lagstein is entitled to punitive damages, which damages will be awarded in accordance with the provisions of NRS 42.005(3).

A. BREACH OF CONTRACT

The Panel assesses damages based upon the fact that Lloyd's had a clear contractual duty to pay something and that its obligation to pay benefits commenced on January 22, 2002, with the first payment due 30 days thereafter. The question before the Panel, then, is not *if* Lagstein is to be awarded contract damages, the question is *how much* money should be awarded in contract damages by reason of Lloyd's' arbitrary and bad faith refusal to pay benefits.

Lloyd's continues, through to the end of the arbitration proceeding, to deny any liability to pay benefits to Lagstein; and, even at the time of the arbitration hearing, *four and one-half* years after payment was due to be commenced, Lloyd's' counsel was still trying to maintain that the elimination period was not met and that no money was ever payable under the policy. It remains perplexing that Lloyd's would

continue to maintain this unreasonable and groundless position in face of the fact that, in compliance with the claims procedures dictated by the policy, all of the treating physicians certified that Lagstein was totally permanently disabled as of October 23, 2002. Whilst maintaining that it has not been obligated to pay *anything* at *any time*, Lloyd's does present a back-up argument that Lagstein's "period of total disability under Underwriters' [Lloyd's] *ended*" when he "returned to work on February 8, 2002." (Emphasis supplied) One might ask how Lloyd's could argue that disability had "ended," when it had never *started*; but that point aside, the Panel must, in assessing damages, deal with Lloyd's assertion that Lagstein's period of disability ended on February 8, 2002.

If Lloyd's is to argue that disability ended on February 8, 2002, the Panel must deal with that argument. With respect to that argument, however, the Panel believes that if there was some point in time at which Lagstein's disability status ended and he became "abled" rather than disabled, it certainly was not as early as February 8, 2002. Only a short period of time before February (in December 2001 and January 2002), Lagstein had been certified by at least three treating physicians as being totally permanently disabled. The Panel accepts the opinions of these treating physicians and, hence, assumes, absent evidence to the contrary, that, only a month of so after disability had been firmly established, Lagstein continued to be disabled and did not lose that status on February 8, 2002, as claimed by Lloyd's.

As explained in this Decision and Award, Lagstein's visiting his medical office on February 8, 2002, was occasioned by and *forced* upon Lagstein by

Lloyd's' refusal to pay him in the manner and at the time promised. As previously stated, "The fact that the insured performs certain post-disability work does not prevent a finding of total disability, where the insured returns to work against the advice of his doctors," as was the case here. The Panel has found and continues to find that Lagstein's disability status certainly was not "ended," as contended by Lloyd's, on February 8, 2002. Moreover, as discussed above, there is not an absolute direct relationship between income and disability, and it is entirely possible for the income of the Lagstein office to have increased as time passed, while Lagstein remained disabled or working disabled. While increased income may be considered in some disability cases as evidence of the end of a disability, the evidence in this case showed that Lagstein's income does not establish any date upon which it can be said that his disability ended.

Irrespective and independent of procedural questions or burden of proof and burden of going forward, the Panel concludes that a preponderance of the evidence demonstrates that Lagstein's permanent total disability status continued uninterrupted from the time it commenced on October 23, 2002, through to the time that this Decision and Award was executed by the Panel. In its policy, Lloyd's agreed to pay benefits to its totally disabled insured "for so long as total disability continues." Thus, Lagstein is entitled to all of the accrued monthly payments of approximately 54 months. In addition, because Lloyd's repudiated the contract, the Panel further awards the remaining six months.

Accordingly, the Panel awards Lagstein Nine Hundred Thousand Dollars ($900,000) as and for his breach of contract damages. The Panel does not,

however, award Lagstein any cost of living adjustment, as he failed to carry his burden of proving what said amounts were.

B. INTEREST

The Panel awards to Lagstein interest on his contract damages, as set forth in NRS 689A.410(1). The Panel finds that the "30 days after the claim is approved" shall constitute 30 days after January 17, 2002, the date Lloyd's had to accept the claim. Lagstein shall submit to an appropriate accounting of said interest to the Panel by September 15, 2006. Lloyd's shall lodge any objections it has to the calculations by October 1, 2006.

C. DAMAGES FOR BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING AND VIOLATIONS OF UNFAIR CLAIMS PRACTICES ACT

The Panel finds that there are three *independent* grounds for awarding damages to Lagstein for his mental and emotional distress, to wit: first, a contractual breach of the implied covenant of good faith and fair dealing; second, a tortious breach of the implied covenant of good faith and fair dealing; and third, the violations of the Unfair Claims Practices Act.

Each ground in and of itself would have justified, in the Panel's view, the award of damages set forth herein.

The core of Lagstein's damage award is the three and one-half year ordeal that Lloyd's put him through. The main element of damages is comprised of the long-term mental and emotional distress suffered by Lagstein. The Panel awards mental distress

damages as part of consequential contract damages and as part of general damages caused by Lloyd's tortious misconduct. The Panel does not intend to award damages for mental distress twice, but, rather, to award a single sum of One Million Five Hundred Thousand Dollars ($1,500,000) for the mental distress that has resulted from both Lloyd's breach of "peace-of-mind" contract and Lloyd's commission of the bad faith and statutory torts.

An award of damages for mental distress in a contract case is an exception to the rule but may be made in such a case where the object of the contract is to secure a psychological benefit such as "peace of mind." Damages flow, not from an independent, actionable wrong, such as the bad faith tort; rather, mental distress damages in a contract case flow from the basic principles of compensatory contractual damages, which require the parties to be restored to the position for which they contracted. Here, Lagstein bargained for a peach of mind that Lloyd's denied him when it breached its contract. Because this factor was part of the bargain and in the reasonable contemplation of the contracting parties, damages for mental distress arising from the breach are recoverable.

The Panel understands, of course, that in normal commercial contracts a breach of contract causing mental distress is not ordinarily within the reasonable contemplation of the parties, and that damages cannot be awarded. The Panel concludes, however, that, in this case, the *object* of the insurance contract was to secure a benefit that, if withheld, would ordinarily bring mental distress upon breach. An award of contract damages for mental distress is an application of the forseeability principle that applies gen-

erally in determining the availability of damages in contract cases. The Panel awards damages for mental distress arising from the breach of contract in the amount of One Million Five Hundred Thousand Dollars ($1,500,000).

Similarly, there has been a tortious breach of the implied covenant. As mentioned, the primary consideration in purchasing insurance of this kind is the peace of mind and security the insurance is designed to provide. It is a given that an insurer's bad faith breach of its duties to an insured is likely to cause mental anguish. A person who is subjected to financial pressures from a refusal of the insurer to discharge its commitments will certainly be subjected to severe stress. See, 16A John Alan Appleman and Jean Appleman, Insurance Law and Practice §8878.55 p 442 (Rev. Vol. 1981)

In a case of this kind, damages for mental anguish may be "general damages" - damages that normally would be anticipated and hence need not be alleged in order to be proved. Marilyn Minzer et al., Damages in Tort Actions §1.01[31](1996) (quoting Restatement (Second) of Torts §904, though miscited as §940). As the Minzer text also explains at §a claim for mental anguish is a classic example of a noneconomic intangible loss. The only standard for evaluation of mental anguish damages "is the amount a reasonable person would estimate to be fair compensation." Id., §3.01[1]

In awarding general tort damages, the Panel looks carefully at Lloyd's conduct. Instead of commencing payment, as was clearly required by the policy, Lloyd's started a campaign of delay-without-

refusal[28] in which it "dangled" the promised benefits in front of Lagstein's face and then, over and over, postpone payment, raising every kind of trivial and groundless pretense for not paying. The maltreatment of Lagstein goes beyond a mere indifference to Lagstein's contract rights and beyond negligent handling of the claim. "Cat-and-mouse" may be the best way to describe the relationship of Lloyd's to its insured. Lloyd's callously ignored Lagstein's please for "mercy," his cajoling, almost begging to be paid what he correctly saw as being plainly his due. This cat-and-mouse game, comprised of Lloyd's leading Lagstein into the false hope that if he jumped through a sufficient number of hoops, payment would be just around the corner, is the essence of cruelty and oppression manifested here.

It appears throughout that just when Lagstein got to the point where he believed his travail was over and that he was going to start receiving much-needed financial support, he would again be told that he had to produce one more unneeded or readily available document or another before payment could be made. It cannot be doubted that such a process was extremely stressful for Lagstein. The record supports a finding that this prolonged teasing caused long-term deterioration of Lagstein's physical health, bringing Lagstein back to the hospital and into a psychiatrist's care. Without again recounting the details of the consequences of Lloyd's' disingenuous and tantalizing conduct, the Panel awards Lagstein, as general tort damages, the sum of One Million Five Hundred Thousand Dollars ($1,500,000).

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[28] "Delay is the deadliest form of denial." Buckminster Fuller.

Again, while there are three different ground upon which the Panel could have awarded these damages, the award is a single award of One Million Five Hundred Thousand Dollars ($1,500,000)

D. ATTORNEYS' FEES AND COSTS

Pursuant to NRS 689A.410(5), the Panel awards to Lagstein Three Hundred Fifty Thousand Dollars ($350,000) as and for his attorneys' fees. The Panel further re-allocates Lagstein's share of the arbitrator's fees paid, the witness fees paid and other legal costs taxable to Lloyd's. The award is pursuant to the Commercial Arbitration Rules of the AAA as provided by the policy. The cost bill shall be filed by September 20, 2006. Lloyd's has until October 1, 2006 to file an objection.

E. PUNITIVE DAMAGES

As required by NRS 42.005, the Panel shall hold a hearing to determine the amount of punitive damages which shall be awarded. The hearing is set, at a location to be determined, for October 24, 2006 unless within five (5) days of this Decision and Award either party schedules a conference call to reset the date. At the hearing, the parties shall introduce calculations of interest on a punitive damage award, if appropriate.

VII.
CONCLUSION

The Panel finds in favor of Lagstein on all claims, assessing damages as set forth herein. The Panel further finds that the amount of punitive damages shall be determined at the separate hearing.

Dated this 31st day of August, 2006

/s/_____
Charles E. Spring

Dated this 31st day of August, 2006

/s/_____
Jerry C. Whitehead

APPENDIX F

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UNITED STATES DISTRICT COURT
DISTRICT OF NEVEDA

Zev Lagstein, M.D.
Plaintiff,
vs.
Lloyd's Underwriters at London, a
foreign insuring entity,
Defendants.
Case No. CV-S-03-1075-LHR-LRL
ADRS Case No. 05-4088

DISSENT FROM ARBITRATION AWARD

HEARING AND APPEARANCES

This matter was arbitrated on July 11, 12, 13 and 14, 2006 by an Arbitration Panel comprised of the Honorable Charles E. Springer, the Honorable Jerry C. Whitehead and Ralph O. Williams III, Esq. in Las Vegas Nevada. Plaintiff, Zev Lagstein, M.D.

(Dr. Lagstein) was represented by Charles J. Surrano, Esq. of the Surrano Law Offices. Defendant, Kiln on behalf of those Certain Underwriters at Lloyd's, London, subscribing to Certificate Number 997401 (Lloyd's) was represented by Joseph M. Rimac and Anna M. Martin of Rimac & Martin.

The following witnesses testified during the arbitration, in order of their appearance, Dr. Lagstein, Raj Chanderraj, M.D. (Dr. Chanderraj), Mary Fuller (Fuller), Charles Bernick, M.D. (Dr. Bernick), Mary Ann Gleason (Gleason), Robert DeLissio (DeLissio) and C. Thomas Gott, M.D. (Dr. Gott). Lagstein and Gleason were present for almost all of the arbitration. Over 1700 pages of exhibits were admitted in evidence. The arbitration was reported by a certified shorthand reporter. Pursuant to the stipulation of the Parties, the Arbitrators will render their award on or before September 1, 2006.

INTRODUCTION

This is a disability insurance case. Dr. Lagstein sues Lloyd's for failure to pay a $15,000 per month total disability benefit. Lloyd's policy provides, "We will begin paying benefits following the elimination period and pay for as long as the total disability continues." "Total disability means that due to sickness and/or injury you cannot perform the substantial and material duties of your occupation and that you are not able to perform in any professional capacity within the medical profession." Dr. Lagstein's last day worked was October 23, 2001 prior to his November 21, 2001 heart valve surgery. The 90 day elimination period ended January 21, 2002. Dr. Lagstein returned to work February 13, 2002 and worked on a reduced basis for the balance of 2002.

Starting January 2003, Dr. Lagstein worked at or above the pace of his best pre-disability months, see Exhibit 1 attached.[1] In January 2003 he conducted 481 office visits, 220 hospital visits and 46 nuclear scans and worked at that rate through July 2004, the last month in evidence. For the Majority to find that Dr. Lagstein was totally disabled i.e. "not able to perform in any professional capacity within the medical profession" after January 2003 demonstrates a manifest disregard for the policy's terms, the evidence and the law. It appears that the Majority's outrage with Lloyd's claims handling has obscured its view of the objective, uncontroverted evidence, essentially mixing claims handling "apples" with breach of contract "oranges".

FACTS

Lloyd's issued an individual disability insurance policy to Dr. Lagstein which, subject to its terms and conditions, pays Dr. Lagstein $15,000.00 per month for as long as he is totally disabled following a 90 day elimination (waiting) period. In order to be totally disabled, Dr. Lagstein must "not [be) able to perform in any professional capacity within the medical profession." If the elimination period is satisfied and Dr. Lagstein goes back to work in any capacity, but earns at least 20% less money than he did before his total disability, the policy pays residual disability benefits. The policy also contains a Relation of Earnings to Insurance Endorsement which provides that

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[1] Exhibit 1, Zev Lagstein, MD. Practice Analysis – October 1999 to July 2004 – Services Performed, summarizes Dr. Lagstein's monthly practice data from his Practice Analysis reports introduced into evidence at the arbitration.

the sum of all of Dr. Lagstein's disability insurance cannot exceed 65% of his pre-disability earnings, Dr. Lagstein was totally disabled following heart valve replacement surgery at the end of 2001 and the beginning of 2002. During the 1999 to 2004 time frame Dr. Lagstein was involved in litigation with Paul Revere Insurance Company over disability benefits owed under an occupation specific (invasive cardiologist) individual disability policy and a disability overhead payments policy.

Below is the time line of facts established during the arbitration with little or no conflict in the evidence.

January 15, 1999: Lloyd's disability policy inception.

October 1999: Dr. Lagstein stops doing invasive cardiac procedures.

September 2000: Dr. Lagstein shifts practice to nuclear medicine and becomes a board certified disability examiner.

August 31, 2001: Cardiac catheterization by Dr. Cohen at UCLA.

October 23, 2001: Dr. Lagstein's last day worked.

November 21, 2001: Dr. Lagstein has value replacement heart surgery at Heart Hospital, Austin, Texas.

December 4, 2001: Dr Lagstein submits disability claim to Lloyds by Proof of Loss submitted by attorney Wood

January 15, 2002: Lloyd's Disability policy expires, non-renewed because claim pending.

January 21, 2002: 90 day elimination period ends

February 13, 2002: Dr Lagstein returns to work in his medical practice

April 5-6, 2002: Dr. Lagstein admitted to Valley Hospital.

May 2, 2002: David Morris & Associates report confirms Dr. Lagstein's return to work in his medical practice.

July 25, 2003: Neurology IME set with Dr. Gott.

July 26, 2002: Cardiology IME set with Dr. Chanderraj.

August 14, 2002: Neurology IME rescheduled date. Dr. Lagstein did not appear. Rescheduled to September 4, 2002.

August 28, 2002: Cardiology IME, Dr. Chanderraj completed.

September 4, 2002: Neurology IME, Dr. Gott completed.

November 6, 2002: Dr. Lagstein deposition in Paul Revere case.

January 2003: Dr. Lagstein working at full capacity.

October 17, 2003: This case filed in U. S. District Court.

May 21, 2004: Lloyd's learns of Paul Revere litigation.

July 29, 2005: Lloyd's denial letter to Dr. Lagstein.

ISSUES

1. Did Dr. Lagstein satisfy the 90 day elimination period?

2. Is Dr. Lagstein entitled to policy benefits? If so, how much?

3. Was Lloyd's conduct during the claim unreasonable, so as to warrant extra contractual damages? If so, how much?

4. Was Lloyd's conduct during the claim fraudulent, oppressive or malicious, so as to warrant punitive damages? If so, how much?

5. Can the Arbitration Panel re-allocate the costs of the arbitration? If so, how much and to whom?

DISCUSSION

1. Did Dr. Lagstein satisfy the 90 day elimination period? Yes.

Dr. Lagstein by his own testimony, confirmed by his appointment books and Practice Analysis reports summarized in Exhibit 1, went back to work as a practicing cardiologist on February 13, 2002. The question is, what date did his disability start? Dr. Lagstein's last day worked was October 23, 2001. This date is supported by Attending Physician Statements (APS) completed by Dr. Benjamin Cohen and Dr. Bernick. Lloyd's states that because the October 23, 2001 date does not correlate to any event documented in the medical records and that because the heart value surgery is elective, Dr. Lagstein's disability onset date is November 21, 2001, the date of his surgery. Neither of the Independent Medical Examiners, Dr. Chanderraj or Dr. Gott opined as to a disability onset date, nor is there any medical review

documented in the claims file setting a different disability onset date. I concur with the Majority in finding that Dr. Lagstein was totally disabled from October 24, 2001 though February 12, 2002, a total of 112 days, satisfying the 90 day elimination period.

2. **Is Dr. Lagstein entitled to policy benefits? Yes. If so, how much? $14,423.75 ($11,000.00 contract benefits and $3,423.75 pre-award interest, per Exhibit 2[2])**

Total Disability: The Lloyd's policy provides: "We will begin paying benefits following the elimination period and pay for as long as the total disability continues." "Total disability means that due to sickness and/or injury you cannot perform the substantial and material duties of your occupation and that you are not able to perform in any professional capacity within the medical profession."

Dr. Lagstein was totally disabled for 112 days, of which 90 were the elimination period, entitling him to 22 days of total disability benefits. The Policy benefit is $15,000.00 per month or $500.00 per day. Policy benefits are: 22 days times $500.00 per day equals $11,000.00.

Disability Period – Burden of Proof: Dr. Lagstein's contends that he is "working disabled" and that he is entitled to the entire contract benefit of $15,000.00 per month for 60 months or $900,000.00. To be entitled to the entire contract

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[2] Exhibit 2 is a spread sheet detailing the pre award interest calculation in accordance with NRS 99.040(1) and calculates the potential awards.

sum, Dr. Lagstein must prove that he is "totally disabled" within the policy's definition i.e. "not [be] able to perform in any professional capacity within the medical profession" for each and every month beyond February 13, 2002. Dr. Lagstein has not carried his burden of proof on this issue. No doctor testified in person, by video conference or declaration that Dr. Lagstein was totally disabled or working against medical advice after he returned to work on February 13, 2002. Dr. Lagstein went back to work as a cardiologist and was still working as a cardiologist as of the arbitration.

It is Dr. Lagstein's burden to prove how long he is disabled. Even assuming that no current medical testimony is required, that the independent medical exams secured by Lloyds are flawed and that Dr. Lagstein was "working disabled" for all 2001, i.e. giving him every benefit of the doubt, the uncontroverted evidence is that after December 31, 2002 Dr. Lagstein performed at his pre-disability level. Exhibit 1 shows that for the first four months of 2001, the year Dr. Lagstein was disabled, he averaged 426 office visits, 254 hospital visits and 63 nuclear scans. For the first four months of 2003, when Dr. Lagstein was performing full capacity, he averaged 482 office visits, 253 hospital visits and 54 nuclear scans. Further, this is not an isolated instance, all the evidence available shows that Dr. Lagstein worked at this pace through July 2004. No trier of fact, based on this uncontroverted evidence could find that Dr. Lagstein was totally disabled and incapable of performing professionally as a physician.

Dr. Lagstein's Credibility: Dr. Lagstein's credibility adversely impacts his claim that he is

"working disabled" and any claim for extra-contractual damages. Dr. Lagstein was not truthful in describing his occupation (Invasive Interventional Cardiologist, which he stopped practicing in 1999) or his duties (all procedures listed providing the majority of his income are invasive or interventional) on his Proof of Loss for Disability Insurance (sent to Lloyd's on December 4, 2001). On his application for Reappointment to the Medical Staff at HEALTHSOUTH question 16 states: "Do you have a physical or mental condition, including alcohol or drug dependence, that could affect your ability to perform your duties and responsibilities as a member of the Medical Staff? Dr Lagstein answered, "No". Later in the application it states, "In applying for reappointment to the Medical Staff of HEALTHSOUTH, I certify that I am in good health, and have the physical and mental capabilities to carry out my duties and responsibilities as a member of the Medical Staff of HEALTHSOUTH." Dr Lagstein signed the application without qualification on January 29, 2002. During the arbitration Dr. Lagstein testified that he lied when he made or affirmed the above statements. Either, he told the truth on the application and is capable of working as a physician or he lied, making him a not credible witness. I would prefer to believe that Dr. Lagstein told the truth and would not put his patients at risk.

Dr. Lagstein did not inform Lloyd's that he went back to work on February 13, 2002. Dr. Lagstein spoke with Lloyds on March 5, 2002 and expressed disappointment that a claims determination had not been made and wanted to know why he was not receiving payments. The truth was the Dr. Lagstein returned to work on February 13, 2002 and conspic-

uously left that fact out of the discussion. Lloyd's learned of Dr. Lagstein's return to work during an April 17, 2002 telephone call to his office and confirmed same by a telephone call on April 24, 2002 and an in person visit on May 1, 2002. Now faced with the fact the Dr. Lagstein claimed that he was totally disabled when he was really at work, Lloyd's requested independent medical examinations. On June 27, 2002 Dr. Lagstein wrote Lloyds claiming, "By all accounts, I was at times critically ill and no IME is necessary for confirmation". What Dr. Lagstein omits is that in June 2002 he conducted 39 office visits, 30 hospital visits and 3 nuclear scans. In an August 1, 2002 letter Lloyds specifically requested dates of Dr. Lagstein's total disability and what other activities he was performing in the medical profession. Dr. Lagstein did not tell Lloyds that in July 2002 he conducted 46 office visits, 31 hospital visits and 6 nuclear scans. On September 12, 2002 Lloyd's requested Dr. Lagstein's total disability dates and "what activities you may be performing now, or were performing in the past within the medical profession since August 30, 2001. Dr. Lagstein did not tell Lloyds that in August 2002 he conducted 30 office visits, 8 hospital visits and 3 nuclear scans. On September 25, 2002 Lloyd's wrote Dr. Lagstein's counsel, "We request details on what activities he (Dr. Lagstein) is performing within his medical practice." Dr. Lagstein's counsel did not tell Lloyds that in September 2002 Dr. Lagstein conducted 60 office visits, 16 hospital visits and 7 nuclear scans. Similar requests were made October 8, 2002 and November 13, 2002. Neither Dr. Lagstein, nor his counsel told Lloyd's what he was doing as shown on Exhibit 1. In a January 3, 2003 letter, Dr. Lagstein states, "I am

totally and permanently disabled". He does not reveal that he has been practicing medicine for the last 11 months and in December 2002 conducted 63 office visits, 16 hospital visits and 6 nuclear scans.

Finally on October 7, 2003 Lloyd's writes Dr. Lagstein stating "you have not supplied us with the information or documentation that supports your claim that your have not been working as a cardiologist since you filed your claim on October 23, 2001. We attach copies of on-line advertisements from July and August 2003, and current listings for you as a recommended physician with two healthcare providers." Dr. Lagstein's October 13, 2003 reply states, "I have already supplied you with all the necessary information a long time ago," omitting that he was practicing at a rate equal to his best pre-disability days documented by his Practice Analysis reports summarized on Exhibit 1.

Pre Award Interest: NRS 99.040(1) sets the prejudgment interest rate as the rate determined by the Commissioner of Financial Institutions on the January or July immediately proceeding the time money becomes due plus two points. Here the Commissioner determined the rate at January 1, 2002 and July 1, 2002 to be 4.75% plus two points for a prejudgment interest rate of 6.75%. Dr. Lagstein is entitled to prejudgment interest on $11,000.00 in the amount $3,423.75 in accordance with the Pre-Award Interest Calculation, Exhibit 2.

Alternative Award Calculation: Viewing the evidence in a light most favorable to Dr. Lagstein, the undisputed evidence is that his total disability ended December 31, 2002, in which case his award would be $217,079.06 ($169,500.00 contractual dam-

ages and $47,579.06 pre-award interest, see Exhibit 2).

Residual Disability: Even though Dr. Lagstein may have been eligible to present a residual disability claim, under the terms of the policy for the period February 13, 2002 to December 31, 2002, he testified that he did not make a residual disability claim. The issue of residual disability was not presented for decision and no evidence was introduced upon which an award for residual disability could be rendered.

3. Was Lloyd's conduct during the claim unreasonable, so as to warrant extra contractual damages? Yes. If so, how much? $4,589.38 attorney fees.

Nevada Revised Statutes (NRS) 686A.310 sets out Nevada's unfair claims practices act and NRS 686A.310.2 authorizes a private right of action for damages for its violation. After extensive research, no authority was located stating that Nevada Administrative Code (NAC) 686A.600 through 686A.675 supports a private cause of action. Absent such authority, the Majority must make new to support its their decision.

Claim Denial: NRS 686A.310.1(d) requires that an insurer affirm or deny a claim within a reasonable period of time. Dr. Lagstein submitted a properly executed proof of loss on December 4, 2001. Lloyd's never objected to the form of Dr. Lagstein's proof of loss. Lloyd's denial letter was sent July 29, 2005. It is not reasonable to take more than three and a half years to deny a claim. All of the facts necessary to deny Dr. Lagstein's claim based on his failure to satisfy the elimination period were known by

the fall of 2001. Lloyd's did not ask the IME doctors to determine the date of disability onset. Nor did Lloyd's conduct an outside medical review to determine the date of disability onset. No contemporaneous internal medical review is documented in the file setting a disability onset date.

Investigation and Communication: Both experts agree that good faith claims handling requires a prompt and fair investigation, giving the insured's interest equal weight with the insurance company's. After Dr. Lagstein returned to work on February 13, 2002, there was a legitimate need to investigate claims of total and residual disability. With reference to total disability, Lloyd's needed to investigate the beginning and ending dates of Dr. Lagstein's total disability (satisfaction of the elimination period) and the extent of other disability benefits available (the Relation of Earnings to Insurance Endorsement). With reference to residual disability, Lloyd's needed to investigate Dr. Lagstein's income level (to calculate benefits) and capacity to perform as physician (to test his level of disability). Although Lloyd's could have done a better job asking questions and letting Dr. Lagstein know why it needed more information, Dr. Lagstein, as detailed above, was not candid in his responses. The covenant of good faith and fair dealing is a two way street. The Majority would have us believe that only Lloyd's must obey the traffic rules and Dr. Lagstein can do as he pleases without consequences.

After Lloyd's learned that Dr. Lagstein returned to work, their requests for Independent Medical Examinations were justified to determine Dr. Lagstein's work capacity and were their right under the policy.

The Majority finds much fault with Lloyd's during the IME process, but is blind to Dr. Lagstein's foot dragging and land of candor. Acknowledging that all claims can be handled better with the wisdom of hindsight, there is no evidence to suggest that Lloyd's acted with reckless disregard as required by American Excess v. MGM, 102 Nev. 601, 605.

Attorney Fees: Dr. Lagstein's fee arrangement is 25% on contractual benefits. Based on Lloyd's failure to timely deny the claim, Dr. Lagstein is entitled to an attorney fee award of $4,589.38, an amount that will net him the awarded policy benefits and pre-award interest.

Emotional Distress: Dr. Lagstein testified that he suffered emotional distress as a result of Lloyd's claims handling. He gave similar testimony in his deposition in the Paul Revere case, which overlapped the Lloyd's matter. No effort was made to allocate between emotional distress caused by Lloyd's and emotional distress caused by Paul Revere. Dr. Lagstein did not produce, by way of live testimony or declaration, any evidence to support his emotional distress damages. Dr. Lagstein did not suffer any financial hardship after January 1, 2003. Exhibit 3[3] shows his financial production from his medical practice averaging $445,323.84 per month for an annual total of $5,343,886.13. Even accounting for collectiblity and overhead and profit, this is a substantial income. Dr. Lagstein looked particularly undis-

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[3] Exhibit 3, Zev Lagstein, M.D. Practice Analysis – October 1999 to July 2004 – Financial Production, summarizes Dr. Lagstein's monthly financial production from his Practice Analysis reports introduced into evidence at the arbitration.

tressed giving a tour of his golf course home, broadcast on a local television channel. In view of Dr. Lagstein's lack of credibility, lack of financial hardship and lack of evidence, an emotional distress award is not warranted.

4. Was Lloyd's conduct during the claim fraudulent, oppressive or malicious, so as to warrant punitive damages? No.

For punitive damages, Nevada law requires a finding of oppression, fraud or malice by clear and convincing evidence, NRS 42.005. There was no showing of oppression, fraud or malice by Lloyd's toward Dr. Lagstein, let alone by clear and convincing evidence. The worst that happened here is that Lloyd's took too long to deny the claim which was in large part was caused by Dr. Lagstein's failure to be forthcoming during the investigation.

5. Can the Arbitration Panel re-allocate the costs of the arbitration? No.

The Arbitration Panel's authority is found in the insurance policy's arbitration paragraph which states, The arbitration will be governed by the commercial arbitration rules of American Arbitration Association." The policy's next sentence states, "Costs for the arbitration shall be equally split among the parties." (Emphasis added.) This specific expression of the Parties' intent controls over any general provision of the AAA rules. To date the Parties have split the cost of the arbitration equally. Any award that does not split the arbitration's cost equally is in excess of the Panel's powers.

APPROPRIATE AWARD

Plaintiff, Zev Lagstein M. D. should be awarded $19,013.13 (policy benefit $11,000.00, pre-award interest $3,423.75 and attorneys fee $4,589.38) against Defendant, Kiln on behalf of those Certain Underwriters at Lloyd's, London, subscribing to Certificate Number 997401. Viewing the evidence in the most favorable light to Dr. Lagstein and giving him every benefit of the doubt, any award more than $290,094.38 (policy benefit $170,000.00, pre-award interest $47,734.69 and attorneys fee $72,359.69) is manifest disregard of the evidence, the insurance policy and the law and/or is in excess of the Arbitration Panel's power.

Dated 9-1-06

/s/_____
Ralph O. Williams III, Esq.

ZEV LAGSTEIN M.D. PRACTICE ANALYSIS - October 1999 to July 2004 - Financial Production

Month	1999	2000	2001	2002	2003	2004
January		11,785.00	$499,605.72	$0.00	$384,119.79	$553,159.50
February		22,310.00	$447,768.40	$12,233.58	$414,5[illegible]3.75	$573,203.88
March		10,795.00	$450,053.66	$30,774.00	$445,711.41	$676,372.16
April		14,648.00	$218,026.66	$23,888.08	$460,155.25	$590,416.50
May		18,470.00	$8,730.00	$44,318.58	$350,607.75	$599,881.74
June		9,235.00	$3,735.00	$33,454.58	$358,382.06	$662,562.90
July		9,160.00	$1,890.00	$48,733.12	$456,418.50	$682,235.40
August		21,614.30	$16,690.00	$27,887.56	$391,382.24	
September		18,828.00	$10,670.00	$41,027.00	$562,187.76	
October	$188,420.00	48,654.12	$2,275.00	$36,049.24	$531,324.34	
November	$197,400.00	16,621.00	$1,950.00	$38,018.56	$468,868.68	
December	$247,095.00	35,005.71	$1,500.00	$40,326.56	$562,190.58	
Total	$632,915.00	$235,123.13	$1,660,894.46	$424,507.78	$5,343,886.13	$4,127,822.06
Monthly Average	$210,971.67	$19,593.59	$138,407.87	$38,618.69	$445,323.84	$589,688.87

Lagstein Pre-Award Interest Calculation

Payment Number	Benefit Due Month	Amount	Date Due	Interest Paid to	Interest Rate	Interest
1	January 2002	$5,000.00	02/13/02	08/31/06	6.75%	$1,566.25
2	February 2002	$5,000.00	02/13/02	08/31/06	6.75%	$1,687.50
3	February 2002	$9,000.00	02/28/02	08/31/06	6.75%	$2,775.94
4	March 2002	$15,000.00	03/31/02	08/31/06	6.75%	$4,539.38
5	April 2002	$15,000.00	04/30/02	08/31/06	6.75%	$4,456.69
6	May 2002	$15,000.00	05/31/02	08/31/06	6.75%	$4,367.81
7	June 2002	$15,000.00	06/30/02	08/31/06	6.75%	$4,283.44
8	July 2002	$15,000.00	07/31/02	08/31/06	6.75%	$4,196.25
9	August 2002	$15,000.00	08/30/02	08/31/06	6.75%	$4,111.88
10	September 2002	$15,000.00	09/30/02	08/31/06	6.75%	$4,024.69
11	October 2002	$15,000.00	10/31/02	08/31/06	6.75%	$3,937.50
12	November 2002	$15,000.00	11/30/02	08/31/06	6.75%	$3,853.13
13	December 2002	$15,000.00	12/31/02	08/31/06	6.75%	$3,765.94
Total		$170,000.00				$47,734.69

Award Feb 02	Amount	$11,000.00
	Interest	$3,423.75
	Total	$14,423.75
Attorney Fees		$4,589.38
Total Award		$19,013.13
Award Dec 02	Amount	$170,000.00
	Interest	$47,734.69
	Total	$217,734.69
Attorney Fees		$72,359.69
Total Award		$290,094.38

ZEV LAGSTEIN M.D. PRACTICE ANALYSIS - October 1999 to July 2004 - Services Performed

	1999			2000			2001			2002			2003			2004		
	Office Visits	Hosp Visits	Nuclear Scans	Office Visits	Hosp Visits	Nuclear Scans	Office Visits	Hosp Visits	Nuclear Scans	Office Visits	Hosp Visits	Nuclear Scans	Office Visits	Hosp Visits	Nuclear Scans	Office Visits	Hosp Visits	Nuclear Scans
January				32	1	0	499	351	80	0	0	0	481	220	48	287	122	80
February				32	20	0	474	247	76	17	5	2	494	234	49	335	107	76
March				23	16	0	513	219	71	33	24	4	491	262	63	451	125	97
April				33	7	0	245	168	24	40	9	5	481	264	59	454	173	89
May				16	35	0	1	0	0	47	4	9	468	139	49	391	181	86
June				23	8	0	0	0	0	39	20	3	439	191	48	420	114	78
July				20	5	0	1	0	0	46	31	5	488	167	61	437	149	82
August				21	48	0	15	13	3	30	8	3	416	206	60			
September				21	22	1	3	3	2	60	16	7	449	212	76			
October	353	171	0	27	21	13	0	0	0	70	7	20	520	222	77			
November	461	294	0	17	17	3	0	0	0	65	6	5	372	150	64			
December	475	314	0	22	31	5	0	0	0	63	16	6	431	148	81			
Total	1,289	889	-	259	232	22	1,728	1,028	266	502	155	70	5,496	2,395	723	2,935	971	603
First Four Month's Average							428	254	63				482	243	54			
Monthly Average	430	230	0	24	19	2	144	86	21	42	13	5	458	200	60	419	139	86

Notes:
1. Offices visits are CPT codes 99205 to 99215
2. Hospital visits are CPT codes 99222 to 99254
3. Nuclear Heart Scans are CPT code 78465. Gated Wall Motion (78469) and Ejection Fraction Gated (78480) are often performed at the same time

APPENDIX G

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA
ZEV LAGSTEIN, M.D.,
Plaintiff,
vs.
LLOYD'S UNDERWRITER AT
LONDON, a foreign insuring entity,
Defendants.
Case No.: CV-S-03-1075 LRH (LRL)

ARBITRATORS' MAJORITY DECISION AND PUNITIVE DAMAGES AWARD

INTRODUCTION

After deciding that an award of punitive and exemplary damages was warranted under the circumstances of this case, the arbitration panel ("Panel") held hearings in Las Vegas on November 21st and 22nd, as required by NRS 42.005, to determine the proper amount of those damages.

I.
THE PANEL DID NOT LOSE JURISDICTION TO AWARD PUNITIVE DAMAGES

Lloyd's contends that the Panel does not have authority to award punitive damages. Lloyd's argues that the Panel's authority ended once it issued its September 1, 2006 Decision and that the Panel could not proceed with the punitive damages hearing. Lloyd's argument is without merit.

A. LLOYD'S COMPELLED LAGSTEIN TO ARBITRATE HIS CLAIMS

This is an insurance bad faith case, arising out of Lloyd's failure to pay disability benefits to Lagstein. Lagstein initially filed this lawsuit against Lloyd's in the United States District Court for the District of Nevada, asserting various claims against Lloyd's, including breach of the implied covenant of good faith and fair dealing, and violations of Nevada's Unfair Claims Practices Act. Lagstein sought compensatory *and* punitive damages.

Lloyd's moved the District Court to compel Lagstein to arbitration based upon arbitration provision contained within the insurance contract. Over objections, the District Court granted Lloyd's Motion for Arbitration.

B. THE MATTER WAS SUBJECT TO THE PROCEDURES FOR LARGE, COMPLEX DISPUTES

It is undisputed that this case was subject to the arbitration agreement which, in turn, provided that the "...commercial arbitration rules of the American Arbitration Association." (Lloyd's Objection to Scheduling of Subsequent Hearing After Expiration of Time to Make Final Award at 2:3) Rule 1 of the AAA Commercial Arbitration Rules provides that:

> (c) Unless the parties agree otherwise, the Procedures for Large, Complex commercial Disputes shall apply to all cases in which the disclosed claim or counterclaim of any part is at least $500,000, exclusive of claimed interest, arbitration fees and costs. Parties may also agree to use the Procedures in cases in-

> volving claims or counterclaims under $500,000 or in nonmonetary cases. The Procedures for Large, Complex Commercial Disputes shall be applied as described in Sections L-1 through L-4 of these rules, in addition to any portion of these rules that is not in conflict with the Procedures for large, Complex Commercial Disputes.
>
> AAA Commercial Arbitration R-1(c) (emphasis added).

Rule L-4 describes the Arbitrators authority to manage the proceedings. The Arbitrators shall "take such steps as they may deem necessary or desirable to avoid delay and to achieve a just, speedy and cost-effective resolution of Large, Complex Commercial Cases." Rule L-4(a). Moreover, while hearings will generally be scheduled on consecutive days to maximize efficiency, Rule L-4(h), as is implicit by awards that the Panel was not required to hold the hearings on "consecutive" days. Therefore, to the extent Rule R-41 conflicts with the Panel's ability to complete the hearings, they are inapplicable.

C. IF PUNITIVE DAMAGES ARE AWARDED, A SUBSEQUENT HEARING MUST BEHELD TO DETERMIN THE AMOUNT

It is well known in Nevada that where a party claims punitive damages, the fact finder must first determine if punitive damages should be awarded and if so, conduct a subsequent proceeding to determine the amount of said damages.

> 3. If punitive damages are claimed pursuant to this section, the trier of fact shall make a finding of whether such

> damages will be assessed. If such damages are to be assessed a subsequent proceeding must be conducted before the same trier of fact to determine the amount of such damages to be assessed. NRS 42.005(3)

Despite this clear mandate of Nevada law, Lloyd's contends that the Panel "closed the hearing" when the issues presented at the July 11, 2006 through July 14, 2006 hearing were submitted. Lloyd's contentions are without merit.

Rule R-35 provides:

> The arbitrator shall specifically inquire of all parties whether they have any further proofs to offer or witnesses to be heard. Upon receiving negative replies or if satisfied that the record is complete, the arbitrator declares the hearing closed. If briefs are to be filed, the hearing shall be closed as of the final date set by the arbitrator for the receipt of briefs. If documents are to be filed as provided in Section R-32 and the date set for their receipt is later than that set for the receipt of briefs, the alter date shall be the closing date of the hearing. The time limit within which the arbitrator is required to make the award shall commence, in the absence of other agreements by the parties, upon the closing of the hearing.

In this case, Lloyd's was well aware that the Panel had to first determine if punitive damages would be awarded and then was required to hold a subsequent hearing to determine the amount of such damages. In light of the foregoing, it is not surprising

that nowhere during that initial hearing did the Panel "declare the hearing closed."

Lloyd's relies upon several comments to contend the Panel "declared the hearing closed." This is not accurate. On July 14, 2006, before the closing arguments, Arbitrator Williams stated:

> We will treat this matter as submitted today at the close of argument. Under AAA rules, a decision is required generally within 30 days. We have reviewed our schedules and our – because we live in disparate geographic locations, our ability to communicate with each other, and we could solicit a stipulation from Counsel that we produce an award on or about September 1st, 2006, a 15-day extension.
>
> (Transcript at 87:20 – 88:4)

The parties agreed that a decision could be made by September 1, 2006. After the closing arguments, the following colloquy took place:

> ARBITRATOR SPRINGER: All right. The matter will stand submitted.
>
> MR. RIMAC: One thing we'd like to say is we will submit the transcripts also. They're being prepared, so we'll submit the transcripts to you gentlemen.
>
> ARBITRATION WILLIAMS: That would be wonderful
>
> (Transcript 159:14-21)

Notably, the transcript was not received until after July 26, 2006 and another portion received later in August, 2006.

It is disingenuous for Lloyd's to argue Arbitrator Williams' comments (which were made before closing arguments) constituted declaring the hearing closed, for it would mean that Arbitrator Williams had already deliberated with the other Arbitrators and determined that punitive damages were not warranted. The Panel had not deliberated and made any such decisions. If fact, the Panel did not deliberate until after the initial hearing which was evident from Arbitrator Williams' comments that they would need additional time to make that decision.

Simply put, under Nevada law, the Panel could not "declare the hearing closed" until it had deliberated and determined whether punitive damages should be awarded because only then would it know whether it would need additional evidence. According to Rule R-40, when the panel consists of more than one arbitrator, a majority is needed to make decisions. The Panel re-affirms that it did not close the hearing as is contemplated by R-41, at the end of the hearing day July 14, 2006.

Consequently, when the Panel issued its September 1, 2006 Decision, it clearly stated that this matter had not been closed. Instead, the Panel declared: "As required by NRS 42.005, the Panel shall hold a hearing to determine the amount of punitive damages which shall be awarded. The hearing is set, at a location to be determined for October 24, 2006 unless within five (5) days of this Decision and Award either party schedules a conference call to reset the date. At the hearing, the parties shall introduce calculations of interest on a punitive damage

award, if appropriate."[1] Neither party objected to the date within the time period specified.

D. RULE R-41 DID NOT PROHIBIT THE PUNITIVE DAMAGE HEARING AND AWARD

Lloyd's next argues that Rule R-41 mandates that an award must be made within 30 days of the hearing being closed unless otherwise agreed by the parties. Lloyd's then contends that because parties agreed to extend the date only to September 1, 2006, the Arbitrators could not award anything beyond that date. Lloyd's position is misplaced for several reasons.

1. The 30-Day Period Did Not Commence Until the Panel Completed the November 22, 2006 – November 23, 2006 Hearing.

Pursuant to the express language of R-41, the 30 days to make an award did not commence running until after the punitive damage hearing was completed. R-41 provides as follows:

> The award shall be made promptly by the arbitrator and, unless otherwise agreed by the parties or specified by law, no later than 30 days from date of closing the hearing, or, if oral hearings have been waived, from the date of the AAA's transmittal of the final statements and proofs to arbitrator.

As discussed above, the Panel did not close the hearing at the conclusion of the July 14, 2006 hearing because it had to first determine if punitive damages

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[1] The subsequent hearing could not be set for an earlier date because Arbitrator Williams was scheduled to be out of the country.

were warranted before it could close it. Furthermore, once the Panel determined that punitive damages would be warranted, the Panel was required as a matter of Nevada law, NRS § 42.005(3), to hold a separate hearing to determine the amount of the punitive damages. Therefore, the 30-day period had not even commenced running until this Panel completed the punitive damage hearing which was held on November 21, 2006 through November 22, 2006.

Moreover, if the Panel was required to hold the punitive damage hearing within 30 days of the July 14, 2006 hearing, it is clear that R-41 conflicts with the Panel's authority under the Complex Rules, which authorized the Panel to take the necessary steps to achieve a resolution of the case. Therefore, R-41 would be inapplicable. *See* Rule R-1.

2. The Panel's September 1, 2006 Decision and Award Constituted an Interim Award

Rule R-34 authorizes the Panel to take interim measures, including the issuance of an interim award. In determining whether an award is final for purposes of judicial review, the Court's have explained that:

> An arbitrator's decision, however labeled, is not a "final" award within the meaning of section 10(d) unless it "resolve[s] all issues submitted to the arbitration and determines each issue fully so that no further litigation is necessary to finalize the obligations of the parties under the award."
>
> *Hart Surgical, Inc.* v. *Ultracision, Inc.*, 92 F.Supp.2d 40, 42 (D. Rhode Island 2000).

In *Hart*, the arbitrators issued an award on liability but not damages; thus, it was not a final award. Likewise, in this case, the Panel had not determined the amount of punitive damages and, therefore, the award was not final.[2]

Consequently, even if the Panel's actions or comments at the July 14, 2006 hearing constituted a "closing of the hearing," this Panel re-opened the hearing in its September 1, 2006 Decision and Award.

Pursuant to Rule R-36, the Panel is authorized to reopen the hearing on its own initiative at any time before the award is made. Lloyd's argues that under Rule R-36, the Panel must have an agreement of the parties. Lloyd's argument is misplaced. Rule R-36 provides that the panel must have an agreement by the parties only if "reopening the hearing would prevent the marking of the award within the specified time agreed on by the parties in the contract(s) out of which the controversy has arisen." There was no time specified in the contract. Rather, the disability insurance policy provided that the arbitration would be governed by the American Arbitration Associations' Commercial Rules. The Panel therefore did not need the parties to agree to have the hearing re-opened.

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[2] Notably, at the punitive damage hearing, counsel for Lagstein questioned the Lloyd's expert, stating that Lloyd's had not paid the order, to which counsel for Lloyd's objected, stating, "There is no final order."

3. The Panel Does Not Lack Authority to Award a Punitive Damage Award, Even If It The Award Was Untimely

Even assuming that the award was untimely, that does not deprive the Panel of authority to make an award or the United States District Court from confirming a late arbitration award. As stated in *McMahon* v. *RMS Electronics, Inc.*, 695 F.Supp. 1557, 1559 (S.D. New York), "a court may confirm a late award if there is no objection, or if there is no prejudice to the losing party caused by the delay." *See also Green* v. *Ameritech Corp.*, 12 F.Supp.2d 662, 665 (E.D. Mich. 1998). The fact that a party loses in arbitration does not constitute prejudice upon which to vacate an award. McMahon, 695 F.Supp. at 1559; and, *Green*, 12 F.Supp.2d at 665 ("This type of prejudice, that is to say, losing the case later, rather than sooner, does not justify the setting aside of an arbitration award.")

Moreover, in *Government of India* v. *Cargill Incorporated*, 867 F.2d 130, 133 (2nd Cir. 1989), the Court emphasized that "the validity of time-bar defenses to the enforcement of arbitration agreements should generally be determined by the arbitrator rather than the court." In *Government of India*, the Government of India had four contracts between it and Cargill, Inc. for the sale of wheat. The contracts contained an arbitration provision to be settled before the American Arbitration Association pursuant to the Grain Arbitration Rules.

In seeking to set aside the award of the Arbitrators, India also argued that arbitrators exceeded their authority under the Grain Arbitration Rules by failing to render an award within thirty days of the filing of the parties' briefs. *Id.* at 132. India claimed

that the hearing technically closed on February 3, 1987, when the arbitrators acknowledge receipt of the parties' briefs on the merits, and that the award was due 30 days thereafter. India claimed that the arbitrators did not have the power to extend the deadline, when they extended it to April 22, and that because the award was late, it was invalid.

The Second Circuit rejected India's arguments, finding that the limitations which an arbitrator has to render his award should be a directory limitation, not a mandatory one. *Id.* at 134. While an arbitrator's decision must be made within a reasonable amount of time, a belated award is invalid only if the parties' agreement itself makes the deadline for filing an award jurisdictional. *Id.* Finally, the Court emphasized that Rule 46 provides the arbitrators with authority to interpret the Arbitration Rules. *Id.*

In this case, the arbitration agreement fails to make the deadline for filing an award jurisdiction. Rule R-53 grants the arbitrators with authority to interpret the rules insofar as they relate to the arbitrator's powers and duties. If the Panel was required to technically issue a Final Award, including the amount of punitive damages by September 1, 2006, the Panel finds that it has authority to extend that deadline to within 30 days of the November 22, 2006 hearing date.

It should be emphasized that the Panel sought to schedule the punitive damage hearing as soon as the Panel and counsel were mutually available. The Panel initially scheduled it for October 24, 2006 which was the earliest date that each of the Arbitrators was mutually available. For example, Arbitrator Williams was scheduled to be out of the country. Lloyd's objected to the October 24, 2006 date. Conse-

quently, the Panel rescheduled it to the November 21, 2006 – November 22, 2006 date. The delay was in part caused by Lloyd's counsel's unavailability.

4. Lloyd's Did Not Timely Object

Lloyd's objected to the date of the October 24, 2006 hearing. Consequently, the Panel re-scheduled it for October 25, 2006. Again, Lloyd's objected to the date, first by way of a letter dated September 19, 2006 and then it its September 26, 2006 Notice of Motion and Motion to Continue Hearing on Punitive Damages. In said motion, Lloyd's requested that the October 25, 2006 date be continued, stating its counsel were unavailable for the scheduled date. Lloyd's attached a copy of a letter its counsel sent on September 19, 2006, where its counsel stated that the reason for objecting was that they were unavailable on October 25, 2006.

Nowhere within the September 19, 2006 letter or the September 26, 2006 Motion to Continue Hearing on Punitive Damages did Lloyd's state a *specific* objection concerning the authority of the Panel to issue an award on punitive damages. Instead, Lloyd's stated in vague language that it was reserving its right to object. That is, Lloyd's stated that it did not "waive and reserve any and all rights to object to the hearing, to the asserted jurisdiction and authority of the panel to conduct the hearing ..."

Lloyd's then filed a petition with the American Arbitration Association to disqualify Arbitrators Springer and Whitehead. Lloyd's next filed a motion with the Panel to recuse Arbitrators Springer and Whitehead.

Instead of asserting a timely objection, Lloyd's waited until nearly six weeks after this Panel issued

its Decision and Award of September 1, 2006 to object to the Panel's authority to hold the punitive damage hearing and award punitive damages. Specifically, on October 13, 2006, Lloyd's served its Objection to Scheduling of Subsequent Hearing After Expiration of Time to Make Final Award. The Panel finds that Lloyd's objection was untimely.

Moreover, Rule R-37 mandates that if a party "proceeds with the arbitration after knowledge that any provision or requirement of these rules has not been complied with and to state an objection in writing shall be deemed to have waived the right to object." In order to preserve its rights, Lloyd's was required to protest against the continuance of the arbitration after the stipulated time had elapsed. *Green*, 12 F.Supp.2d at 664; and, *see also McMahon*, 695 F.Supp. at 1558 (counsel failure to respond to AAA's request for an extension of time limit before that limit expired constituted waiver of deadline notwithstanding counsel objection letter).

The Panel finds that Lloyd's failed to object when it sought its continuances of the October 24th and October 25, 2006 hearings, it waived its right to object to this Panel's authority to hold the punitive damage hearing and issue its award on punitive damages.

E. INTEREST ON AWARD

The Panel is in agreement that the interest due under the contract damage award as of November 22, 2006 is ONE HUNDRED NINETY-THREE THOUSAND NINE HUNDRED FIFTY and 17/100 DOLLARS ($193,950.17) and adopts Arbitrator Ralph Williams' spread sheet.

F. AWARD OF ARBITRATORS' FEES

The Panel reverses its finding of September 1, 2006 and finds that the cost of the arbitrators should be equally split between the parties even though Lagstein is the prevailing party, under the AAA rules, the arbitrator's fees may not be shifted to Lloyd's.

G. DISCUSSION OF PUNITIVE DAMAGES

Although the Panel unanimously ruled "Lloyd's conduct during the claim unreasonable, so as to warrant extra contractual [tort] damages" (Dissent, p. 10), the Panel was not unanimous in its decision to award punitive damages. A majority of the Panel is now faced with the task of assessing the amount of punitive and exemplary damages against "Lloyd's."

In Defendant's Brief on Punitive Damages, the Panel is told that the actual party-defendant here is a Lloyd's insurance syndicate called "Kiln, on behalf of certain Underwriters at Lloyd's London subscribing to Certificate No. 997401." Although there is one defendant, a number of "Lloyd's" entities are involved here ("Corporation at Lloyds," the "Society of Lloyds," "Lloyds Underwriters," "Kiln" and IRMG). Defendants refer to three of these, "*Underwriters*," "Kiln" and IRMG, somewhat interchangeably. For example, Lloyd's' "disability insurance consultant," Robert DiLisio, "regularly refers to IRMG as Underwriters"; and Lloyd's, in its Statement of Undisputed Facts, at one point writes that "Underwriters wrote to all the physicians ..." and at other times writes, "*IRMG* wrote to Dr. Lagstein and explained ... ." The Panel will continue to use the name "Lloyd's" as an inclusive term, including defendant and the other mentioned entities.

In its previous decision, the Panel found:

1) That on December 4, 2001, Lloyd's received a properly executed proof of loss statement. Lagstein then met the elimination period of the policy as of January 22, 2002.

2) Lloyd's should have advised pursuant to state law of the acceptance or denial of his claim by January 17, 2002.

3) Lloyd's failed to advise in writing that it needed more time, pursuant to state law.

4) The argument advanced as to Lagstein's not meeting the elimination period was pure pretense.

5) Lloyd's violated numerous aspects of the Unfair Trade Practices Act.

6) Lloyd's wrongfully refused to commence benefit payments when they became due.

7) In the claims adjusting process, Lloyd's attempted to rewrite the policy.

8) The actions of the company put their insured's life at risk and those of his patients.

9) The company ignored or intentionally violated statutes, regulations and standards and created an extended delay in an attempt to escape obligations under the policy.

10) The company engaged in post-claims underwritings

11) The company made false excuses for nonpayment

12) The company breached the implied covenant of good faith and fair dealing and the Nevada Unfair Claims Practices Act.

13) That the non-renewal letter appeared to coerce settlement and it was not given in time.

14) That numerous problems existed with the handling of the IMEs including giving false information to the insured, not advising him of the policy language and misrepresenting the law.

II.
EVIDENCE PRESENTED AT THE NOVEMBER HEARING:

The Panel finds that:

(1) Lloyd's, both during the claims handling process; after the bad faith lawsuit was filed; during the July arbitration; after the Panel's decision finding bad faith; and through the punitive damage hearing, has at all times made a conscious and intentional decision to avoid acquiring any knowledge of the case.

(2) Lloyd's gave complete autonomy to IRMG to administer the claim as it saw fit. Lloyd's, a $110 billion company, assigned the claims handling of many cases to a company with only 13 employees and then provided no supervision or oversight.

(3) The claim languished for 3-1/2 years before it was denied. During that period of time, Lloyd's kept no records to show the age of this file or any other file and no records that would tell them how long any file had been pending before acceptance or denial. During this period, Lloyd's required no reporting of the handling of the file to its claim department.

(4) During the 3-1/2 years pending denial, the company never had one conversation with IRMG about the file.

(5) Lloyd's testified that during the entire period the claim department did not review the files, but they had an auditing company look at a random sampling of files. Lloyd's supplied no information as to the number of files sampled; no evidence showing that this file was ever looked at; and no evidence as to the purpose of the audit or questions asked.

(6) The first and only supervision of Lloyd's claims department was to review the denial letter. Dr. Lagstein's denial letter was read by Ashley Lawrence of Lloyd's, London. In it, he was informed that the disability started on October 23, 2001, the claim was filed on December 1, 2001 and it was not denied until July 29, 2005. He was comfortable with this claims handling.

(7) When a suit was filed alleging bad faith in the claims handling of the case, Lloyd's did not review the claim file and did not attend the hearing except through counsel.

(8) When this Panel's decision of September 1, 2006 was handed down, the same indifference continued. Lloyd's claim manager did not look at the claims file and did not read the available transcript.

(9) Lloyd's deliberately avoided any information of the file before the punitive damages hearing so that they could attend the hearing and state that they had no knowledge of the case.

(10) Lloyd's only action was to contact a law firm with whom they worked to review both the file and the hearing to see if they received a fair hearing, i.e., a possible appeal. Rather than having the file reviewed by specialists in insurance claims handling procedures who could advise as to the proper handling of future claims, they sought a law firm who

themselves did not process claims but whose report would be protected by the attorney-client privilege when presented to them.

(11) Lloyd's gave the law firm no sense of urgency as to when to report so that in the two months the firm had, they still had not reported on the claims handling of this claim at the time of the hearing.

(12) Lloyd's has made no attempt to discover what other claims were handled in the same fashion by IRMG.

(13) Lloyd's, having insulated itself from any information whatsoever from IRMG's conduct, then testified at the hearing that IRMG was a reasonable, honest and fair claims administrator.

(14) Since Lloyd's was *comfortable* with a 3-1/2 year time to accept or deny a claim, the actions of IRMG met Lloyd's standards and were ratified by them.

IRMG CEO AVOIDED UNCOVERING ANY INFORMATION ABOUT THIS CASE

(1) The CEO of IRMG's 13 employees did not review the claims file when they were sued for bad faith.

(2) The CEO of the company did not attend the July 2006 hearing.

(3) The CEO of the company did not read the claim file after the July 2006 hearing.

(4) The CEO of the company did not read the transcript of the July 2006 hearing.

(5) The CEO of the company never looked to see if there were any audits of the file.

(6) The CEO of the company did not agree with the Panel's decision as of November 22, 2006, although he has no information about the claims file or the evidence from the July 2006 hearing.

PETERSON INTERNATIONAL UNDERWRITERS

Robert Peterson of Peterson International Underwriters was the author of the faulty non-renewal letter. He also was without information about the claims file, or the evidence produced at the hearing. Nevertheless, he also does not agree with the finding of the Panel as to their bad faith.

THE POSITION OF THE DEFENDANTS AS TO THEIR CONDUCT

From Lloyd's attorney:

> ... IRMG and Lloyd's of London ... They have handled this claim as well as a human being, as well as any insurance professional could have.
>
> Transcript July 14,2006 p 151

> President of IRMG said that if a similar type of case came up in the future, she would handle it the same way
>
> Transcript July 13, 2006 p 302-303

The claims manager of Lloyd's, the CEO of IRMG and Peterson of Peterson International Underwriters each disagreed with the decision of bad faith without a single one having reviewed the file.

III.
DEFENDANT'S ACTIVE CORPORATE WRONGDOING

The Panel's finding that Kiln-Lloyd's is guilty of "active wrongdoing" is based on its being guilty of "direct" or "corporate" "tort liability" as distinguished from indirect, derivative liability, which is related to acts of employees or agents acting within the scope and. power of their employment or agency. Direct corporate liability is liability based on wrongful acts conducted by a corporation *itself*. (See, e.g. Thompson v. Nason Hospital, 591 A.2r 703 (1991)

The Panel concludes that there are *two* kinds of direct, corporate or institutional "active wrongdoing" for which Kiln-Lloyd's must answer in punitive damages. The *first* kind of corporate wrongdoing is comprised of acts performed directly for the corporation by the person put in charge of the handling and disposing of the Lagstein claim – Mary Ann Gleason of IRMG. Gleason is found by the Panel to have been acting not as an insulated, "independent" third party claims administrator, that Lloyd's seems to be claiming, but, rather as a direct managing claims agent of the corporation, who has been given direct corporate authority to handle and dispose of the Lagstein claim for the corporation. The panel finds that Gleason's acts are the corporation's acts; and Lloyd's is *directly* responsible for Gleason's actions.

The *second* kind of "direct," corporate liability is predicated upon the general obligation of an insurance company to provide reasonably prompt claims services to its policy holders and more specifically upon Lloyd's failure to supervise those assigned to claims adjustment and its systemic fault in failing to formulate and enact adequate claims policies and procedures.

That Lloyd's is guilty, the two ways just described, of the institutional and corporate commis-

sion of the bad faith tort and liable for punitive and exemplary damages is based on the following findings and conclusions:

1. *Defendant Kiln-Lloyd's direct, corporate liability for the tortious acts of Mary Ann Gleason.* The Panel concludes that, aside from any possible secondary liability, Lloyd's is guilty of institutional, corporate wrongdoing. Lloyd's can, of course, act in its corporate capacity, *as* a corporation, only through authorized corporate agents. Lloyd's granted full corporate power and authority to manage and settle the Lagstein claim to its agent and attorney, Mary Ann Gleason. Although Lloyd's would like to say that it has protected itself by hiring a "third-party claims administrator" (IRMG), however, it cannot avoid liability in this way. Ms. Gleason was an integral part of Lloyd's claims process and given full power to act as a decision-making claims manager for the corporations. Ms. Gleason testified that she had full authority to dispose of the Lagstein claim on behalf of Lloyd's and was not even required to make periodic claim reports to Lloyd's, except "*as a courtesy*." With this kind of unrestrained power and authority, in managing this claim and in disposing of this claim for the Lloyd's corporation, Gleason was acting not only *for* the corporation but, directly, *as* the corporation. In addition to having what appears to be virtually unlimited authority to act in the name of and on behalf of Lloyd's, Ms. Gleason also testified that she was acting in the capacity of attorney to Lloyd's Underwriters, claiming attorney-client privilege in this regard. (Decision, p. 4, fn. 2.) On July 29, 2005, Ms. Gleason, over three and one-half years after Dr. Lagstein filed his claim, wrote a letter to him, denying the claim; or, as put in the Lloyd's' Statement of Undisputed Facts: "By letter dated July 29, 2005, Un-

derwriters (i.e. Kiln-Lloyd's) denied Dr. Lagstein's claim ... ." Kiln-Lloyd's, ("Underwriters") denied the claim, through Gleason, who was, at least, a *de facto* corporate agent specifically authorized and empowered to act in the name of the corporation and *as the* corporation. The Panel wishes to be clear in its meaning here on the subject of Gleason's relationship to Kiln-Lloyd's: Gleason was empowered to act in the name of Kiln-Lloyd's, and Gleason's wrongful actions were, by reason of the nature of the authority granted to Gleason, corporate actions. Gleason's actions were Kiln-Lloyd's actions, and both are guilty of "active wrongdoing."

Although Lloyd's may insist that the defendant corporation was "not directly involved in handling Lagstein's claim," Lloyd's clearly was *involved* directly. The Kiln Underwriters corporation was just as directly involved when its attorney Mary Ann Gleason acted in its name as it would have been involved had Ashley Lawrence "claims manager at Kiln," been the corporate decision-maker who wrote the Lagstein claim denial letter for Lloyd's. Although, as conceded by Lloyd's, defendant Kiln would be vicariously liable for commission of the bad faith tort (and subject under certain conditions to punitive damages), the situation here goes beyond secondary, vicarious liability because Gleason was empowered to act directly and unrestrictedly in the name of the defendant.

2. *Systemic Wrongdoing: Failure to enact claims procedures and failure to superintend claims procedures.* Defendant Lloyd's Underwriters is directly liable for malicious and grossly negligent corporate mismanagement in failing to set up claims procedures and failing to supervise and superintend the

claims operations of Mary Ann Gleason and IRMG. The failure of Lloyd's (under whatever name or guise), Underwriters, Kiln, IRMG or Mary Ann Gleason to install claims procedures and their other violations of Nevada Law has been covered in the Panel's Decision. Kiln-Lloyd's' Claims Manager Lawrence having not read the claims file at the time of the Punitive Damages hearing, that he did not know of any of the details of the handling of the claim reinforces the Panels finding and conclusion that Kiln is directly responsible for the suffering and the injury and damages sustained by Dr. Lagstein. In sum, then, Kiln-Lloyd's is guilty of direct corporate bad faith in not prescribing written procedures for handling claims. Kiln-Lloyd's not providing claims procedures and not giving suitable oversight and supervision to claims adjustment procedures displays an indifference and a reckless disregard for the rights and health and safety or its claimants and, especially of Dr. Lagstein; and. so, defendant should be mulcted by an award of punitive and exemplary damages.

3. Summary of Kiln's "Active Wrongdoing. Kiln-Lloyd's continuing to conduct its claims settlements without the adoption of any written claims procedures and permitting claims handling in the Lagstein matter to go unsupervised and unattended to for over three and one-half years calls for some explanation. The hearings before the Panel did not provide any sustainable explanation for these deficiencies in insurance practices. Punitive damages against Kiln-Lloyd's for commission of the bad faith tort in a malicious oppressive and fraudulent manner will be assessed on the following basis: (1) Punitive damages are to be assessed against Kiln-Lloyd's by reason of the deliberate, malicious, oppressive and fraudulent acts committed by Kiln-Lloyd's in the

manner that, through Ms. Gleason, defendant handled the claims adjustment operation in the Lagstein claim (as further detailed in the Panel's Decision); (2) Punitive damages are to be assessed against Defendant by reason of corporate bad faith exhibited in the form of defendant corporation's failure to supervise the claims portions of its insurance business and its failure to put in place procedures for the governance of the claims-adjustment process; (3) Punitive Damages are also allowable on the basis of vicarious liability.

THE STANDARDS FOR PUNITIVE DAMAGES

The Supreme Court in *Gore* has listed some items which are of assistance to the Panel in determining how *bad* Lloyd's was under the "new federal standard" on punitive damages. These "aggravating" items are: (1) whether the harm was physical rather than economic; (2) whether the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; (3) whether the conduct involved repeated actions or was an isolated incident; and (4) whether the harm resulted from intentional malice, trickery or deceit.

The following matters have been considered by the Panel:

(1) The harm to Dr. Lagstein is economic but also physical. As stated in the Panel's Decision, Lloyd's knew that Lagstein was "vulnerable" and nearly at the end of his rope. The harm created by Lloyd's resulted in Lagstein's having to seek a physician's (psychiatrist's) treatment and to be hospitalized for medical treatment for his condition. The Panel concludes that this aggravating factor is present in this case.

(2) With respect to the reprehensibility, the blameworthiness, inherent in both the direct, malicious misconduct of Defendant corporation, corporate agent Gleason and in Lloyd's systemic indifference to the welfare of its insureds (failure to adopt procedures and failure to supervise), the Panel concluded that Lloyd's is guilty of extremely reprehensible and harmful conduct. Of all the forms of bad faith that might be engaged in by insurance carriers, perhaps the most insidious is the abuse of persons who are suffering from disabilities and are dependent upon the insurance company for sustenance. Lloyd's knew that that Lagstein's health and safety were in jeopardy when he was being put through the long and excruciating delays catalogued in the Panel's decision. There can be no doubt about the reprehensibility of Lloyd's conduct or of the harm that has been done to Dr. Lagstein by Lloyd's.

(3) The question of how "isolated" or widespread Lloyd's misconduct is incomplete because of the lack of information submitted by Lloyd's. Lloyd's, rather unpersuasively, tries to convince the Panel that the Lagstein abuses are "isolated" events. In support of this proposition Lloyd's tells us that there has never been a bad faith tort judgment entered against this particular insurance syndicate. Lloyd's does admit that it has had bad faith claims asserted against it but insists that these claims have been settled out of court and have not been reduced to judgment. Neither the number nor the amounts of these settlements were disclosed. It taxes our credulity to be asked to accept as a fact that the type of unsupervised claims handling, lack of practices and procedures, and the attempt to delegate all claims responsibility has not resulted in other misconduct. It is very hard to conclude that Lloyd's was not treating a

large number of claimants in the same way it treated Dr. Lagstein; and it is highly probable that the mode of claims handling seen here resulted in other unjustifiably rejected, or least unreasonably and wrongly delayed, claims. The fact that defendants were united in seeing no harm to this repeated infraction indicates that, for the company, it was business as usual. Additionally, the president of IRMG testified that future claims would be handled in the same manner. Certainly, claims manager Lawrence's admission that he still had not read the Lagstein file at the time of the punitive damages hearing and that he was not conversant with claims handling is evidence that many claimants must have failed to receive proper attention and that many complaints relating to mishandling of claims have gone unheard.

Lloyd's, by oral testimony, declared that they had paid 90% of their claims. No documentary evidence was presented to support this assertion. Of even greater significance, Lloyd's did not advise the Panel concerning the size of the claims rejected, i.e., were the large claims such as this one denied or a greater percentage than the small ones? The Panel can make no finding in this regard.

As the Panel sees the situation, the sample "audits," mentioned by Mr. Lawrence in his testimony, said to have been conducted did little or nothing to protect the rights and claims of Lloyd's claimants. We know that there have been past bad faith claims. Lloyd's claimants have had nowhere to turn; no one at Lloyd's to complain to. No one who should be listening is listening to the plaints of abused claimants.

(4) On the question of whether Lloyd's can be said to have been guilty of intentional malice, trickery or deceit, the Panel has concluded that IRMG

and Mary Ann Gleason were engaged in a scheme to deprive Dr. Lagstein of his disability benefits. Although the Panel has not held that Lloyd's was guilty of directly scripting Gleason's "cat-and-mouse" game, described in its Decision, Lloyd's would appear to be the principal beneficiary of such an arbitrary claims-denying scheme.

The Panel believes that an award of punitive damages In the sum of FOUR MILLION DOLLARS ($4,000,000) is appropriate

VI.
AWARD

The Arbitration Panel awards a punitive and exemplary damage award, against Defendant and in favor of Plaintiff, in the amount of FOUR MILLION DOLLARS ($4,000,000).

DATED this 14th day of December, 2006 — /s/ Charles E. Spring

DATED this 14th day of December, 2006 — /s/ Jerry Carr Whitehead

APPENDIX H

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UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA
Zev Lagstein, M. D.
Plaintiff,
vs.
Lloyd's Underwriters at London, a foreign insuring entity,
Defendants.
Case No. CV-S-03-1075-LHR-LR
ADRS Case No. 05-4088

DISSENT FROM ARBITRATORS' MAJORITY DECISION AND PUNITIVE DAMAGES AWARD

HEARING AND APPEARANCES

The Arbitration Panel comprised of the Honorable Charles E. Springer, the Honorable Jerry C. Whitehead and Ralph O. Williams III, Esq. reconvened in Las Vegas Nevada on November 21 and 22,

2006 for a second session. Plaintiff, Zev Lagstein, M.D. (Lagstein) was represented by Charles J. Surrano, Esq. of the Surrano Law Offices. Defendant, Kiln on behalf of those Certain Underwriters at Lloyd's, London, subscribing to Certificate Number 997401 (Kiln) was represented by Joseph M. Rimac and Anna M. Martin of Rimac & Martin and Evan M. Tager of Mayer, Brown, Rowe & Maw.

The following witnesses testified during second session of the arbitration, in order of their appearance; Nigel Burton Brown, Robert Carney, Thomas Petersen and Ashley Lawrence. Lagstein and Lawrence were present for all of the second session of the arbitration. One three inch ring binder of Lagstein exhibits was admitted in evidence. The proceeding was reported by a certified shorthand reporter.

INTRODUCTION

This is a disability insurance case. Lagstein sues Kiln for failure to pay a $15,000 per month total disability benefit. The Arbitration Panel's Majority (the Majority) issued its award on September 1, 2006. The Undersigned issued his Dissent the same day. The Majority determined that Kiln's conduct warranted the imposition of punitive damages and set the second session of the arbitration to determine the amount of punitive damages. The Majority also requested interest and cost calculations from Lagstein, allowing Kiln to object to the calculations. Kiln filed objections to the second session of the arbitration contending that pursuant to American Arbitration Association Commercial Arbitration Rules governing this arbitration, the Arbitration Panel's authority terminated with the September 1, 2006 Award.

ISSUES

1. Does the Arbitration Panel have jurisdiction to conduct the second session of the arbitration?

2. How much pre-award interest is to be awarded to Lagstein?

3. Can the Arbitration Panel shift the cost of the arbitration between the Parties?

4. What is the proper amount of punitive damages to be assessed against Kiln?

DISCUSSION

1. Does the Arbitration Panel have jurisdiction to conduct the second session of the arbitration? No.

The Parties' arbitration agreement states, "The arbitration will be governed by the commercial arbitration rules of the American Arbitration Association (AAA)." The hearing was closed pursuant to AAA Rule 35 on July 14, 2006 after both sides rested and Justice Springer declared, "All right. The matter will stand submitted." AAA Rule 41, "Time of Award" provides "The award shall be made promptly by the arbitrator and, unless otherwise agreed by the parties or specified by law, not later than 30 days from the date of the closing of the hearing." With the Parities agreement, the time for making the award was extended to September 1, 2006. The Majority's Decision of Arbitration Panel and Award and the Undersigned's Dissent from Arbitration Award were filed and served September 1, 2006.

The Majority attempted to set a hearing to determine pre-award interest, costs and the amount of punitive damages for October 24, 2006. Counsel for Kiln immediately objected to this hearing and has

continued to object at every opportunity. Over Kiln's objection the hearing was rescheduled for November 21 and 22, 2006.

Under the AAA rules, the only way that the Arbitration Panel could take further action beyond September 1, 2006 would be if the action was taken within the time to modify an award pursuant to AAA Rule 46 or the hearing was reopened pursuant to AAA Rule 36. Neither of which happened.

AAA Rule 46, "Modification of Award" sets out a procedure to modify clerical, typographical or computational errors in the award at the request of a party within 20 days of the award. The arbitrator is not empowered to redetermine the merits of any claim already decided. No party requested that the award be modified and the time to request modification expired September 21, 2006.

AAA Rule 36, "Reopening of Hearing" provides, "The hearing may be reopened on the arbitrator's initiative, or upon application of a party, at any time before the award is made.... When no specific date is fixed in the contract, the arbitrator may reopen the hearing and shall have 30 days from the closing of the reopened hearing within which to make an award." The Majority knew that it wanted to conduct a further hearing, but inexplicably failed to issue an interim award pursuant to AAA Rule 43(b) and reopen the hearing as authorized by AAA Rule 36. Instead it issued its Decision of Arbitration Panel and Award, ending its jurisdiction in this matter.

Finally, there can be no doubt that the time for making the award is jurisdictional and not procedural. AAA Rule 38, "Extensions of Time" provides, "The parties may modify any period of time by mu-

tual agreement ... The arbitrator may for good cause extend any period of time established by these rules, except the time for making the award (emphasis added...." AAA Rule 38 prohibits the Arbitration Panel from extending the time for making the award, absent the agreement of the parties. The Parties agreed to extend the time for making the award to September 1, 2006 and no further.

In finding that the Arbitration Panel's jurisdiction terminated with the Award and Dissent filed on September 1, 2006, it is unnecessary to discuss the other issues presented. However, so that there is a complete record for the Majority, the Parties and any reviewing Court, the remaining issues are discussed below.

2. How much pre-award interest is to be awarded to Lagstein? $193, 950.17.

The Arbitration Panel awarded pre-award interest to Lagstein on all amounts due at the time of the Award. Pre-award interest for claims arising from health insurance is calculated beginning 30 days after the amount is due at 6% over the prime rate determined by the Nevada Commissioner of Finance, NRS 689A.410(1). Health insurance includes disability insurance, NRS 681A.030. Because Lagstein's disability policy provides for monthly payments, interest accrues 30 days after each monthly payment is due. Attached as Exhibit 1 to this Supplemental Dissent is a spread sheet making this calculation in the amount of $193,950.17, using the Majority's contract damage award.

3. Can the Arbitration Panel shift the cost of the arbitration between the Parties? No.

The Arbitration Panel's authority found in Lagstein's disability policy's arbitration paragraph states, "The arbitration will be governed by the commercial arbitration rules of American Arbitration Association." The policy's next sentence states, "Costs for the arbitration shall be equally split among the parties" (emphasis added). This specific expression of the Parties' intent to share the cost of the arbitration equally controls over any general provision of the AAA Rules allowing arbitrators to shift costs. To date the Parties have split the cost of the arbitration approximately equally. Further, there is insufficient evidence for the Arbitration Panel to attempt a dollar for dollar "true up". Any award that does not divide the arbitration's cost equally is in excess of the Arbitration Panel's powers.

4. What is the proper amount of punitive damages to be assessed against Kiln? $50,000.00.

Although the Majority determined that Kiln's conduct warranted punitive damages, there was no analysis of Kiln's conduct independent of IRMG's[1] The Undersigned did not find clear and convincing evidence of fraud, oppression or malice on the part of IRMG, let alone Kiln. However, in accordance with the Arbitration Panel's order to the Parties not to relitigate the case, this discussion will be limited to the

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[1] IRMG, International Risk Management Group is a third party administrator designated by Kiln to investigate, adjust and pay disability claims such as Lagstein's.

proper amount of punitive damages to be assessed against Kiln.

Kiln has a non-delegable duty to adjust Lagstein's claim in good faith in accordance with Nevada law. Kiln's worldwide claims director acknowledged this duty and responsibility for IRMG's bad faith claims handling. He testified that compensatory verdict of $2,943,950.17 (contract damages of $1,193,950.17 for disability benefit and pre-award interest and extra-contractual damages of $1,850,000.00 for emotional distress and attorneys' fees) would be paid in full, if the Majority's award is affirmed.

Kiln moved that the Arbitration Panel not consider evidence of Kiln's financial condition in making its punitive damages award, because none of the cases reviewing punitive damage awards from a constitutional due process point of view, allow consideration of the defendant's wealth as a factor. The Arbitration Panel admitted evidence of Kiln's financial condition so that the record would be complete, but granted Kiln's motion and will not consider evidence of Kiln's financial condition in making its punitive damage award.

The United States Supreme Court in *State Farm* v. *Campbell*, 538 U. S. 408, articulated a three part test to determine the amount of punitive damages; reprehensibility of the defendant's conduct, ratio of compensatory damages to punitive damages and comparable civil penalties for the same conduct.[2] Reprehensibility has a five part inquiry; Is the harm

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[2] This standard was adopted by the Nevada Supreme Court this summer in *Bongiovi* v. *Sullivan* 138 Pac.3d 433 (July 2006).

physical or economic, does the tortious conduct evince an indifference to or a reckless disregard of the health or safety of others, is the target of the conduct financially vulnerable, is the conduct repeated or isolated and is the harm the result of intentional malice, trickery or deceit?

To set the amount of punitive damages against Kiln, we must assess Kiln's conduct toward Lagstein. Kiln is responsible for IRMG's less than stellar claims handling and is going to pay for it in the form of substantial extra-contractual damages noted above. However, Kiln's reprehensibility is measured by its conduct.

Reprehensibility

Was the harm to Lagstein physical or economic? The harm was economic. He was deprived of a policy benefit in the form of a monthly stipend. The majority found that Lagstein suffered emotional distress, with scant evidence of physical manifestation, for which it fully compensated him in the amount of $1,500,000.00.

Does the tortious conduct evince an indifference to or a reckless disregard of the health or safety or others? The worst that Kiln is guilty of is the failure to supervise its agent IRMG. The undisputed evidence was that Kiln conducted due diligence on IRMG before hiring it 11 years ago and conducted annual audits to make sure Kiln's standards were met. Kiln was not on notice of any problems with IRMG prior to the Award. Once the Award was rendered, it was reviewed with senior management and counsel was engaged to conduct a full independent review of the entire Lagstein claim from beginning to end. Lawrence testified that all counsel's recommen-

dations will be implemented. He further testified that he was extremely distressed by IRMG's poor claims handling conduct found by the Arbitration Panel.

Is the target of the conduct (Lagstein) financially vulnerable? No. Lagstein is a man of substance. Any financial distress was at least equally caused or contributed to by Paul Revere failing to pay a greater policy benefit in the same time frame arising from the same disability. By January 2003 Lagstein was producing revenue at his predisability rate and was never in economic jeopardy.

Is Kiln's conduct repeated or isolated? This is an isolated incident against Lagstein. *State Farm* and *Bach* v. *First Union National Bank*, 149 Fed. Appx. 354 (2005) make it clear that the complained of conduct must be directed against multiple persons, rather than an extended course against one person. *Bach* rejected the proposition that testimony that the claimant was treated the same as others was an admission of repeated violations. Carney testified that in IRMG's 11 year existence there had never been an adverse verdict or arbitration award arising from the denial of a claim by IRMG. Lawrence testified in accord with IRMG and that there had never been an adverse verdict against Kiln for breach of contract, let alone bad faith claims handling. Even Lagstein's expert, Brown testified that Kiln was a well run syndicate and that he was surprised by the Lagstein award. Lawrence acknowledged that Kiln had been sued for bad faith claims handling and that cases had been settled before trial. This is the day to day business of insurance, not the stuff of punitive damages.

Is the harm the result of intentional malice, trickery or deceit? Kiln did not know Lagstein. Lawrence testified that neither he nor Kiln bore Lagstein any ill will. The only direct knowledge Kiln had of the Lagstein claim was the approval of the July, 2005 denial letter. The letter on its face reveals that the claim took almost four years to process. This is evidence of poor claims handling for which Kiln is paying, not intentional malice, trickery or deceit.

Evaluating the five factors that make up reprehensibility, Kiln's conduct fails at the very low end of the scale when compared to the conduct discussed in *Planned Parenthood* v. *American Coalition of Life Activists*, 422 Fed. 3d 949.

Ratio

State Farm holds that in practice few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process. The Court pointed out that a 4 to 1 ratio drew upon a long history of sanctions of double, treble or quadruple damages to deter and punish and that such a ratio might be close to the constitutional line. Where the victims of State Farm's conduct were compensated with substantial compensatory damages $1,000,000.00) the Court observed that a punitive award at or near the amount of the compensatory damages might be justified i.e. a 1 to 1 ratio. See also the Ninth Circuit's discussion and case comparisons in *Planned Parenthood*.

The Majority's award fully compensates Lagstein for all harm suffered. He was awarded $900,000.00 with no evidence that he was disabled within the policy definition after January, 2003 along with pre-award interest. Note that Nevada's regular pre-

judgment interest statute is the prime rate plus two percent. Because Lagstein's claim arose from health insurance as defined by Nevada Revised Statutes, he was awarded pre-award interest at the prime rate plus 6 percent. This differential appears to be in the nature of a civil penalty to discourage poor claims practices in the administration of health insurance in Nevada. To the extent that Lagstein suffered emotional distress, he has been fully compensated at $1,500,000.00. Finally, he was awarded attorney's fees of $350,000.00.

Using *only* a ratio test, the upper limit of any punitive damage award against Kiln is 1 to 1.

Comparable Penalties

The final factor is the difference between the punitive damages award and civil penalties for comparable conduct. NRS 686A.183(1)(a) provides a maximum civil penalty for an insurer who violates the Nevada insurance code of $5,000.00. Totaling up the Majority's findings of bad faith conduct, whether statutory or otherwise, taking them all as true and supported by the evidence without doubt; there are eight violations; untimely claims decision, withholding policy benefits due, post claims underwriting on Lag-stein's heart murmur, the notice of non-renewal, the independent medical exams, failure to enact reasonable claims procedures, burdensome and unnecessary requests for information and failing to treat Lagstein's interest equal to its own. These eight violations times $5,000.00 each, suggests an punitive damage award of $40,000.00.

Taking all the factors together, very low reprehensibility, low ratio (Lagstein fully compensated and Kiln paying bad faith damages) and comparable

maximum civil penalty of $40,000.00, the appropriate punitive damages award is $50,000.00, but under no circumstances on this record should it exceed $150,000.00. The compensatory damage award is punishment enough for poor claims handling and will deter Kiln from such conduct in the future.

CONCLUSION

The Arbitration Panel's jurisdiction terminated with the rendering of its September 1, 2006 Award and it is not authorized by the Parties' contract or the American Arbitration Rules to take any further action.

If the Arbitration panel has jurisdiction to make further orders and awards, then it should order and award as follows:

1. Plaintiff, Zev Lagstein M. D. should be awarded $193,950.17 for pre-award interest and $50,000.00 for punitive damages against Defendant, Kiln on behalf of those Certain Underwriters at Lloyd's, London, subscribing to Certificate Number 997401.

2. Plaintiff, Zev Lagstein M. D. should take nothing for costs of the arbitration against Defendant, Kiln on behalf of those Certain Underwriters at Lloyd's, London, subscribing to Certificate Number 997401.

Dated:12-18-06

/s/_____
Ralph O. Williams III, Esq.

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IN THE

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CERTAIN UNDERWRITERS AT LLOYD'S, LONDON,
Petitioner,

v.

ZEV LAGSTEIN,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF PETERSEN INTERNATIONAL UNDERWRITERS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF PETERSEN INTERNATIONAL UNDERWRITERS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICUS CURIAE* [1]

This *Amicus* Brief is filed on behalf of Petersen International Underwriters ("Petersen"), an underwriting firm which focuses on providing insurance for extraordinary risks that the traditional market cannot or will not insure.

[1] Pursuant to Rule 37.6 of the Rules of this Court, *amicus* states that no counsel for a party has authored this brief, in whole or in part, and that no person or entity, other than *amicus* or its counsel, has made a monetary contribution to the preparation or submission of this brief. Letters have been filed with the Clerk of the Court confirming that all parties have consented to the submission of *amicus* briefs, including this one.

By way of experience, Petersen is well aware that contractual arbitration, whether through the American Arbitration Association or otherwise, plays a vital role in the amelioration and resolution of commercial disputes. Arbitration is cost effective and relieves the courts of burdens they would otherwise have to assume.

Much like the courts, trust and confidence in the integrity and impartiality of the process are necessary underpinnings to the willingness of parties to take part in arbitration. If that trust is impeached, or there is even the appearance of untrustworthiness or lack of transparency and integrity, arbitration will be avoided by sophisticated commercial parties.

Amicus has a vital interest in the continuing ability of the insurance market to rely upon and utilize commercial arbitration as a means of dispute resolution. Absent trust in the process, that cannot be accomplished.

Reliance on the integrity of the process requires reliance on the enforceability of arbitration agreements as written and the certainty that any potential conflict or relationship between the arbitrators themselves will be fully disclosed in order to have confidence in a fair and impartial bearing.

Moreover, if the insurance market comes to the conclusion that the Federal Arbitration Act performs as a bar to any judicial review of a perceived flawed arbitration award predicated on lack of disclosure, arbitration will cease to be a forum for dispute resolution that the insurance industry is willing to adopt.

The Ninth Circuit's decision in the instant case undermines the insurance industry's faith in the Federal Arbitration Act's fairness and impartiality.

Amicus thus brings its concerns to the Court's attention.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION UNDERMINES THE INTEGRITY OF THE ARBITRATION PROCESS

From the point of view of *Amicus*, the most compelling defect, and the one with the most far ranging consequences, in the decision below is the Ninth Circuit's preclusion of a federal court's ability, in the appropriate egregious circumstances, to vacate an award because of the arbitrators' failure to disclose relationships and dealings between themselves which rise to the level of casting doubt on the fairness of the process. The Ninth Circuit's parsimonious interpretation of the arbitrators' disclosure obligation cannot be squared with this Court's materially broader conception of that obligation. Moreover, contrary to the Ninth Circuit's view, the burden of disclosure, from a fairness and cost benefit point of view, should be on the potential arbitrators. A requirement that the parties undertake an investigation is simply not cost effective and such an investigation is likely to be less complete.

From a broader point of view, bias refers to a "predisposition to decide a cause on an issue in a certain way, which does not leave the mind perfectly open to conviction." *Pacific and Southwest Annual Conference of United Methodist Church v. Superior Court*, 82 Cal.App.3rd 72, 86 (1978).

Bias can certainly flow from a relationship with a party, which is why disclosure of such a relationship is required.

It is also the perception of bias which must be eradicated. Where a history between arbitrators is at the level found here, the perception of bias is sufficient, especially where a judicial fitness inquiry was involved.

Given the numerous ways bias can be present, the Ninth Circuit's narrow interpretation of the disclosure duty under the FAA prevents the parties from using the disclosure duty as a means to ferret out even obvious biases and predispositions.

Under the Ninth Circuit's rationale, an arbitrator with a relevant history can easily avoid the Ninth Circuit's limited disclosure requirements by simply stating he has no prior dealings with a party or a party's counsel, while simultaneously failing to reveal multiple professional, commercial, personal, and, as here, ethical histories with another panel member. The opportunity for unfairness is patent.

In *Commonwealth Coatings Corp. v. Continental Casualty*, 393 U.S. 145 (1968) this Court struck precisely the right tone in phrasing the disclosure obligation in terms of dealings, rather than relationships. Dealings have both positive and negative connections.

Neutrality is best served when potential arbitrators are up front about any sort of past dealings, whether with a party, counsel, or other panel member which might hint at or suggest an inability to act impartially.

Significantly, the very act of disclosure is more often than not sufficient to dispel any concern and reenforces ones' confidence in the process.

By contrast, the failure to disclose serves, at a minimum, to suggest that the undisclosed dealings may very well be indicative of an inability or unwillingness to act impartially or independently.

Accordingly, the Ninth Circuit's decision conflicts with *Commonwealth Coatings*, *supra*, by relieving arbitrators of the duty to disclose prior dealings with each other.

In the instant case, from the point of view of *Amicus*, who must rely on the integrity of the Arbitration process in future commercial disputes, or abandon its use, it matters little whether there was actual malfeasance or bias on the panel. Rather, it is the perception of bias and lack of impartiality which destroys a third party's confidence in the system and imparts a reluctance to future use of this method of commercial dispute resolution.

If there can be no recourse to the courts to review of such circumstances, there is a chilling effect on sophisticated entities' agreement to arbitrate disputes.

It is apparent from the record that two of the three arbitrators had dealings with each other that suggest a predisposition to act in tandem, rather than independently. It is clear that the two arbitrators have a long shared history. It is equally clear that a substantial part of that shared history revolved around claims of bias and judicial misconduct.

The very existence of this history casts substantial doubt on the prospect that a fair impartial hearing would take place, and fairness compels disclosure.

Under the standard put forth by the Ninth Circuit, the disclosure obligation is gutted, doing great damage to public perception of the arbitration process.

II. THE NINTH CIRCUIT'S DECISION HANDS ARBITRATORS THE POWER TO REWRITE THE PARTIES' CONTRACT, FRUSTRATING ALL CONTRACTUAL EXPECTATIONS

In addition to the evisceration of the disclosure obligation, the Ninth Circuit's decision hands arbitrators unreviewable discretion to increase the duration and expense of the arbitration.

Jurisdiction for arbitrators is confirmed by the parties' agreement, and the letter of the agreement, including time limitations, defines the jurisdiction.

Under the Ninth Circuit's rationale, once initial jurisdiction is extended, the arbitrators are free to extend their jurisdiction beyond the contractual agreement of the parties, and the parties are powerless to enforce any previously negotiated and agreed upon jurisdictional limits.

The parties define the arbitrator's power by their agreement. In *Stolt-Nielsen S.A. v. Animal Feeds Int'l Corp.*, 559 U.S. 130 S. Ct. 1758, 1774 (2010), the Court explained "an arbitrator derives his or her powers from the parties' agreement" and the "parties are generally free to structure their arbitration agreements as they see fit . . . and may agree on rules under which any arbitration will proceed." Permitting arbitrators to unilaterally expand that power beyond the agreement undermines confidence and reliance in the process. *Amicus* expects, in agreeing to submit matters to arbitration, that the agreed upon boundaries will be adhered to. If not, arbitration becomes an unattractive alternative to litigation.

III. THE NINTH CIRCUIT'S DECISION ABANDONS THE COURTS' OBLIGATION TO POLICE THE PROCEDURAL FAIRNESS OF ARBITRATIONS CONDUCTED UNDER THE FEDERAL ARBITRATION ACT

In order for commercial entities such as *Amicus* to continue to rely on contractual arbitration as an efficient, cost effective way of resolving disputes, it must be assured that the arbitration agreements it enters into are enforced as written in conformity with the expectations of the parties.

The decision of the Ninth Circuit is clearly in conflict with the notion of such reliance, and conflicts with the FAA, 10 U.S.C. Section 10(A) which seems to provide the courts with the power to rein in arbitration excess.

It is essential that in the event arbitrators step substantially beyond contractual arbitration boundaries that the courts have the jurisdiction and power to reset the boundaries. One of the attractions of the commercial arbitration process is that the parties are able to set the parameters and issues to be decided. *Stolt-Nielsen*, 130 S.Ct. at 1774. In the event arbitrators decide to unilaterally disregard the parties' agreement simply because they believe they know better, or wish to do so for any other reason, the courts must have the authority to roll back the unconsented extra-jurisdictional exercise of authority by the arbitrators.

The instant case is a particular illustration of the hazard to the insurance industry if arbitrators are allowed to exceed their jurisdiction.

It is chiefly within the context of the insurance industry that a tortious breach of contract founded

upon a breach of the covenant of good faith and fair dealing can result in an exemplary damages award. *See, e.g. Freeman & Mills, Inc. v. Belcher Oil Co.*, 11 Cal.4th 85, 103, 900 P.2d 669, 680 (1995).

This represents a substantial commercial exposure, and given that contractual arbitration provides arbitrators with the power to significantly damage an insurer, the need for trustworthiness, transparency and full disclosure is underscored. The opinion of the Ninth Circuit is a strong disincentive to continue to rely on contractual arbitrations as a means to resolve insurance disputes.

The arbitration system has many benefits. However, if the Ninth Circuit's decision is allowed to stand, continued usage of the system is perhaps fatally imperiled.

CONCLUSION

For the foregoing reasons, together with those stated in the Petition, *Amicus* respectfully requests that the Court grant the Petition for Writ of Certiorari.

Respectfully submitted,

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BRIEF OF ROLLINS, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF ROLLINS, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*[1]

Amicus Curiae Rollins, Inc. (hereinafter Rollins) is a premier North American consumer and commercial services company. Rollins provides essential pest control services and protection against termite

[1] Pursuant to Rule 37.6 of the Rules of this Court, *amicus curiae* states that no counsel for a party has authored this brief, in whole or in part, and that no person or entity, other than *amicus*, its members, or its counsel, has made a monetary contribution to the preparation of submission of this brief. Letters have been filed with the Clerk of the Court confirming that all parties have consented to the submission of this brief.

damage, rodents and insects to over two million (2,000,000) customers in the United States, Canada, Mexico, Europe, Central America, the Caribbean, the Middle East, Asia and the Mediterranean. The company operates in over 500 locations around the globe.

Rollins provides these services through wholly owned subsidiaries, including:

1. Orkin, LLC;
2. HomeTeam Pest Defense;
3. Western Pest Services;
4. PCO Services;
5. The Industrial Fumigant Company;
6. Waltham Services; and
7. Crane Pest Control.

Rollins prides itself on its ethical, cost-effective work. As part of that commitment to honesty and integrity, Rollins provides many of its customers with a streamlined means of dispute resolution through contractual arbitration.

The Mediation/Arbitration provision used by Rollins' subsidiary, Orkin, in its residential agreements provides that arbitration shall be administered under the rules of the American Arbitration Association ("AAA"). Its arbitrations are also subject to the Federal Arbitration Act. *Amicus* has a vital interest in the enforcement of its arbitration agreements as written, and in the integrity of the arbitration process.

Contractual arbitration avoids the expense and delays of litigation; allows the parties to craft, through the use of precise contractual terms, the

scope and focus of the dispute resolution mechanism to ensure efficient resolution of contractual disputes; and provides a means for customer service corporations and their customers to resolve disputes in a quick, effective, dependable and predictable manner.

Consumer and commercial service corporations place great emphasis on arbitration as an alternate dispute resolution technique. In concert with the widespread use of arbitration, these same corporations, and the consumers who purchase goods and services from these corporations, should be able to rely on the arbitration agreement, and should be able to control the scope and focus of the arbitration process. This should include the ability to rely on the specifically agreed-to contractual terms as to the arbitration procedure; the ability to rely on the integrity of the arbitrators; and the ability to confirm that the arbitrators are limited to interpreting the terms of the parties' contract, rather than engaging in wholesale contractual rewrites and expansions of the arbitral scope. If these rights are not protected, it will become impossible to continue to include arbitration agreements in customer service contracts.

Amicus relies on maintaining access to dependable, cost-effective alternate dispute resolution. Because the Ninth Circuit's decision in this case undermines that reasonable reliance, *Amicus* brings its concerns to this Court's attention.

SUMMARY OF ARGUMENT

The continued viability of arbitration as a dispute resolution device is dependent on protecting the integrity of the process. If arbitrators are permitted to play "hide the ball" as to their qualifications, experience, training, or background, then the process

is at risk of inconsistent results, prejudice to one or both parties, and ultimately a fraud on the system, which would nullify the process as an acceptable alternative to traditional litigation. This would result in parties reverting back to litigation as not just the primary dispute resolution tool, but the only dispute resolution alternative.

The Ninth Circuit's ruling below demonstrates an inappropriate policy of abstention in arbitration cases. It is incumbent on this Court to clarify the law so that arbitration results, like the result below which the district court found biased, will not be allowed to stand based on the misguided notion that courts have no role under the FAA to ensure that the arbitral process works fairly and rationally.

ARGUMENT

I. THE CONTINUED VIABILITY OF ARBITRATION AS A DISPUTE RESOLUTION DEVICE IS DEPENDENT ON PROTECTING THE INTEGRITY OF THE PROCESS

The continued viability of arbitration as an efficient cost effective resolution of disputes is wholly dependent on the arbitration process remaining fair and free of subversion and trickery.

The Ninth Circuit's decision will damage *Amicus's* ability to rely on the efficiency and cost-effectiveness of arbitration. By giving the arbitrators unreviewable authority to expand the scope of arbitration hearings beyond that set by the parties' agreement, the Ninth Circuit has made contractual arbitration a far less predictable and dependable means of dispute resolution.

This Court has long held that the parties are in control of the structure of the arbitration: "Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit." *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989). The Ninth Circuit's ruling here contravenes that essential understanding by holding that the arbitrators may disregard the parties' efforts to structure the arbitration as the parties see fit.

If parties to a contract cannot dependably set the scope and structure of their arbitration process, they cannot control costs or ensure an efficient proceeding. The Ninth Circuit's ruling thus appears to be in direct conflict with this Court's statement in *Volt*. By turning a blind eye to what the Ninth Circuit casts as "mistakes" in contractual construction, thereby allowing arbitrators to assess liability against corporations for failing to provide unpurchased services, the Ninth Circuit has abdicated too much authority to arbitrators.

In *Volt*, this Court reaffirmed the rule that, under the FAA, the parties may exclude certain claims from the scope of their arbitration proceedings. 489 U.S. at 478. The Ninth Circuit here acknowledged that the arbitrators ruled on a claim that was outside the scope of the arbitration proceeding, based on an alternate form of coverage that was not a part of the parties' contract, but held that such "mistakes" were within the arbitrators' discretion.

This Court recently explained the difference between misreading a contract and reading new terms and agreements into the contract, and held that arbitrators exceed their power when they read new

terms or agreements into a contract. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1770 (2010). While contract interpretation is a matter for the arbitrators, contract expansion is in excess of arbitral powers. *See Id.*, at 1773-1774.

Under the Ninth Circuit's rule, an arbitrator can hold companies liable for a failure to provide unpurchased services, and even award punitive damages for a failure to provide unpurchased services—which is precisely what the arbitrators did in this case—and the courts can do nothing to intervene.

In such situations the parties never intended unpurchased services or unwanted coverages to be a part of their agreement. While the parties may turn to arbitrators to interpret their agreement, they do not give arbitrators the power to expand that agreement in violation of the basic offer-acceptance-consideration triumvirate of contract formation.

The Ninth Circuit's decision cannot be reconciled with this Court's repeated statements that the parties are free to set, by contract, the scope of their arbitration proceedings. Similarly, the Ninth Circuit's decision cannot be reconciled with sound business practices. Companies will not utilize arbitration as an alternative dispute resolution device if they may be held liable for punitive damages for a failure to provide unbargained-for, unpurchased services.

Amicus expects that its relationships with its customers will be governed by the terms of their contract. It is important that the courts be able to intervene where, as in the underlying action here, the

arbitrators rewrite the operative terms of the parties' agreement.

II. THE NINTH CIRCUIT'S RULING TYPIFIES AN INCREASINGLY PREVALENT POLICY OF EXCESSIVE ABSTENTION IN ARBITRATION CASES

This Court recently confirmed that Congress's purpose in enacting the FAA was to replace judicial indisposition to arbitration with a national policy favoring arbitration. *Hall St. Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 581 (2008). Abstention in the face of facts that clearly indicate arbitral bias is contrary to this Court's prior decisions, to the interests of customer service businesses, and indeed to all honest users of contractual arbitration.

This Court has held that arbitrators must "disclose to the parties any dealings that might create an impression of possible bias." *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 149 (1968). Nonetheless, the Ninth Circuit's ruling here, which retreats significantly from that instruction, is not an isolated problem. Rather, a number of courts have become less likely to intervene when an arbitrator is shown to have failed to disclose dealings that may rightly suggest a potential for bias. The following present two examples of how courts are misunderstanding their roles in policing arbitral authority.

In *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F.Supp.2d 862 (N.D.Tex.2004), *aff'd as modified*, 436 F.3d 495 (5th Cir.2006), *rev'd*, 476 F.3d 278 (5th Cir. 2006) (*en banc*; 11-5 opinion), *cert. denied*, 127 S.Ct. 2943 (2007), Peter J. Shurn III, an attorney, in undertaking to serve as the sole arbitrator of a major commercial dispute, made repeated false and misleading statements on disclosure forms.

Attorney Shurn was asked on one form: "Have you had any professional or social relationship with counsel for any party in this proceeding or with the firms for which they work?" Shurn falsely insisted several times, and one time under written oath, that he had nothing to disclose. *Id.*, at 879-880. The district court vacated, but the Fifth Circuit, sitting *en banc*, ultimately reversed.

The dissenting judge in the Fifth Circuit's *en banc* reconsideration of *Positive Software* lamented the sacrifice of arbitration integrity to the expediency of arbitral finality. *See Positive Software*, 476 F.3d at 286 (Reavley, J., dissenting). The dissent was blunt: "I dissent because this court may not overrule a decision of the Supreme Court." *Id.* This dissent highlights the shift away from *Commonwealth Coatings* that has taken place in multiple circuits over the intervening years.

As the dissent in *Positive Software* noted, a number of circuits have chosen to disregard *Commonwealth Coatings* by arguing—inaccurately—that the decision does not represent an opinion of the majority of this Court's justices. *See Id.*, at 287; *see also Schmitz v. Zilveti*, 20 F.3d 1043, 1045 (9th Cir. 1994) ("*Commonwealth Coatings* is not a plurality opinion, however.")

Judge Reavley in *Positive Software* explained the danger of focusing on finality over integrity:

> While I can understand the desire to protect the finality of arbitration awards and avoid a return to extended court expense and delay, this does not justify evading the law of the Supreme Court by misstating it or by avoiding it by bleaching the evidence of possible partiality. Nor should we miss the need to promote the impartiality of arbitrators in this time when that is the favored

> method of dispute resolution. Influence can so easily corrupt the decision-making process even when it is not recognized by the magistrate or arbitrator himself. And to prove bias or improper influence is rarely possible. It is imperative that we not allow even the good faith or memory of the potential arbitrator to control the disclosure decision for, as the Justices made clear in *Commonwealth Coatings*, it is the protection and reassurance of the party that matters most.

Positive Software., 476 F.3d at 288 (Reavley, J., dissenting).

Some state courts also believe, mistakenly, that they are powerless to intervene even where the undisclosed information indicates a clear suggestion of bias. In *Haworth v. Superior Court,* 50 Cal.4th 372, 112 Cal.Rptr.3d 853, 235 P.3d 152 (2010), the California Supreme Court was presented with an arbitration award arising out of a female patient's claim that her physician was negligent in performing cosmetic surgery on her lip. The superior court vacated an award in favor of the physician on the ground that the arbitrator failed to disclose a matter that could create a reasonable doubt as to the arbitrator's ability to be impartial under California law. The California Supreme Court disagreed, holding that the arbitrator, a former judge, was not required to disclose that, "10 years earlier, he received a public censure based upon his conduct toward and statements to court employees, which together created 'an overall courtroom environment where discussion of sex and improper ethnic and racial comments were customary.'"

The *Haworth* and *Positive Software* decisions take the opposite course of Justice White's influential con-

currence in *Commonwealth Coatings*. There Justice White explained that the role of "judge of the arbitrator's impartiality" is best played by the parties themselves, "who are the architects of their own arbitration process, and are far better informed of the prevailing ethical standards and reputations within their business" than are the courts. *Commonwealth Coatings*, 393 U.S. at 151 (White, J., concurring). The parties can only play this role if disclosure requirements are enforced. *Id.*

The dissent in *Haworth* echoed Justice White's analysis. The dissent disputed the majority's reasoning "that plaintiff's medical negligence and battery claims do not present the type of dispute in which gender stereotypes and biases are likely to play a part." *Haworth*, 50 Cal.4th at 398 (Werdegar, J., dissenting). Rather, the parties, not the courts, should make that determination, and can do so only by enforcing disclosure requirements. *Id.*, at 395. Justice Werdegar emphasized that "the arbitration system must have—and must be seen to have—sufficient integrity that parties can be confident they will receive a fair hearing and an impartial decision from the arbitrator." *Id.* A female litigant's concern that she could not receive a fair hearing on a cosmetic surgery dispute from a judge who had been censured "for making repeated, overt and demeaning sexual comments in chambers to his female staff members" is reasonable. *Id.* "In condoning the failure of disclosure here, the majority sacrifices system integrity on the altar of arbitral finality." *Id.*

Justice White in *Commonwealth Coatings*, Justice Werdegar of the California Supreme Court in *Haworth* and Judge Reavley in *Positive Software* find common footing in the notion that the parties should

have the right to judge the qualifications of their prospective arbitrators for themselves. Disqualification need not automatically follow disclosure—so long as the arbitrators disclose relevant dealings, the parties may choose to proceed knowing that all cards have been laid on the table. *See Commonwealth Coatings*, 393 U.S. at 151 (White, J., concurring).

In *Commonwealth Coatings*, this Court set the standard at the disclosure level of a potential for bias. 393 U.S. at 148-150. Complaints filed by a state Commission on Judicial Discipline alleging judicial misconduct and corruption leading to a non-prosecution agreement to leave the bench and never again serve in a judicial capacity is a "dealing" that should be disclosed. It is simply not credible to assert that a party can have no qualms about the integrity and fairness of such a person serving as arbitrator.

Justice White cautioned in his *Commonwealth Coatings* concurrence: "the judiciary must [not] overlook outright chicanery in giving effect to [arbitration] awards; that would be an abdication of our responsibility." 393 U.S. at 150.

The Ninth Circuit has abdicated its responsibility to enforce disclosure obligations. The expediency of arbitral finality has been elevated too far above the need to ensure the integrity of the process. As a result, it is now harder to obtain fair and unbiased arbitral proceedings and results. No business can rely on such an easily manipulated system to resolve disputes—particularly where the decisions are virtually unreviewable.

The parties can only be assured that their arbitration process has a minimum of integrity if prospective arbitrators disclose dealings that might, if undisclosed, cause a party to reasonably question

their integrity, impartiality or independence. The petitioner is correct, the circuits are in disarray, and this Court's intervention is necessary to ensure the continued integrity of the arbitration process.

Judicial abstention in such circumstances is contrary to this Court's instruction. Similarly, abstention in the face of apparent corruption is contrary to this Court's repeated insistence that arbitrators must go about their tasks honestly. *See Hall St.*, 522 U.S. at 585-586; *United Paperworkers Int'l Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29, 38 (1987) ("decisions procured by the parties through fraud or through the arbitrator's dishonesty need not be enforced"); *Commonwealth Coatings*, 393 U.S. at 150 ("We cannot believe that it was the purpose of Congress to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another").

The troublesome aspect of both *Positive Software* and *Haworth* is that, as with the Ninth Circuit's decision here, those cases illustrate a pervasive problem where a number of courts have failed to appreciate that they have the kind of responsibility that Justice White underscored to make sure that the arbitral process is being conducted with integrity from initial selection of arbitrators to issuance of the final award. Unless this Court takes affirmative steps to prevent these types of abuses, reviewing courts throughout the land will continue to blindly allow arbitrator misconduct to flourish.

In the case at bar, the arbitrator selected and paid by the respondent failed to disclose that he was forced off the Nevada bench amidst charges of cor

ruption. That arbitrator then arranged for one of his longtime defenders to serve as the third arbitrator. Neither arbitrator disclosed those ties, let alone that the ties related to charges of corruption. The two arbitrators then ruled in every regard in favor of the party that arranged for their service. After the arbitration award was issued, the first arbitrator billed and received over Seventy-five Thousand Dollars ($75,000.00) from the prevailing party. *See* Ninth Cir. Docket No. 55

The Ninth Circuit is quick to point out that petitioner, in its due diligence, could have uncovered these facts. Even if this is so, the parties should not be forced to conduct detailed background investigations of all potential arbitrators, and the intentional cover-up of salient facts should not be rewarded. Arbitrators sit in the chairs of the judiciary as quasi-jurists, and should be held to a higher standard than, "if you snooze, you lose."

There is significant evidence that the awards in this case were not the product of honest deliberation. Indeed, the district court found that the awards exhibit bias, not just an appearance of bias, but actual bias. If the parties can be blind-sided by bias that may result in unsuitable or even corrupt arbitrators crafting irrational decisions that support undisclosed predeterminations and the courts refuse to intervene, the future of arbitration as an alternate dispute resolution option is bleak.

Corporations, in the face of this judicial reticence to correct faulty disclosures by arbitrators or aberrant arbitration decisions, will revert back to the relative safety and predictability of litigation, with its avenues of appeal. While traditional litigation may have its own pitfalls, businesses will become willing

to accept them when the alternative is to face the potential for rogue arbitral decisions that leave a company with no recourse.

Arbitration has long served the purposes of the customer service industry to provide to its customers a means to resolve disputes without the added cost and time commitment of litigation. If the decision of the Ninth Circuit is allowed to stand, arbitration will begin to pose too many risks, with too few rewards, to remain a viable choice for customer service firms. It is up to this Court to save arbitration by eschewing excessive judicial abstention and reestablishing some ground rules for arbitral integrity and procedural predictability through judicial oversight under the FAA.

The integrity of the arbitration process will be severely undermined if arbitrators are free to subvert the process by secreting salient facts related to their fitness to sit as arbitrators on the hopes that no party will uncover these facts prior to choosing to employ them as an arbitrator. The decision of the Ninth Circuit serves as an invitation to those with unsavory backgrounds to offer services for which they will be well paid by the parties, in the hopes that either a background check will not be performed, or will not ferret out the otherwise unacceptable behavior.

The appearance of impropriety of a sitting judge would not be tolerated. Similar conduct by one who sits as a "quasi-jurist" should also not be tolerated or protected. The benefits of policing the system to ensure that arbitration remains a process free of guile and obfuscation far outweigh the burdens of, once having discovered a deception on the part of an arbitrator, having to re-arbitrate the matter. Just as the integrity of the judicial system would not

permit such conduct on the part of a judge, neither should quasi-judicial proceedings be a haven for this patently improper behavior.

CONCLUSION

For the reasons stated herein, and in the petition, *amicus* requests that this Court grant the petition for writ of certiorari filed by Certain Underwriters at Lloyd's, London.

Respectfully submitted,

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